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A treatise on the law pertaining to corporate finance including the financial operations and arrangements of public and private corporations as determined by the courts and statutes of the United States and England, by William A. Reid ... Albany, H. B. Parsons, 1896.

2 v. 24½cm.

Paged continuously.

1. Corporations—Finance. 2. Corporation law—U. S. 3. Corporation law—Gt. Brit.

12—37921

Library of Congress [42c1]

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A TREATISE ON THE LAW

PERTAINING TO

CORPORATE FINANCE

INCLUDING

THE FINANCIAL OPERATIONS AND ARRANGEMENTS

OF PUBLIC AND PRIVATE CORPORATIONS

AS DETERMINED BY

THE COURTS AND STATUTES

OF THE UNITED STATES AND ENGLAND

By

WILLIAM A. REID

OF THE NEW YORK BAR

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VOL. I

ALBANY

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PREFACE.

This work is a practical treatise upon the law of "Corporate Finance" — The Financial Operations and Arrangements of Public and Private Corporations — as declared by the courts in a large collection of cases. The idea in the preparation of the work has been that a lawyer searching for law adapted to his case would be aided by a work giving the rules declared by the courts, and, as far as necessary, showing how these conclusions were reached, the reasoning of the courts, and the application of the law to the particular cases as exemplified by the facts therein. In the text such a statement of facts, when necessary, has been made as will give an accurate idea of the case presented to the court, and the rules declared. The notes contain, in many cases, the full reasoning or argument of the courts in support of the rules, and frequently a differentiation of cases which may be assumed to be in conflict with the rules declared.

Especially has the author thought a work prepared upon this plan would be of great use to those who have not access to large libraries. I trust it may prove a ready and useful help to those who may use it.

WM. A. REID.

NEW YORK CITY, *January*, 1896.

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CORPORATE FINANCE

THE FINANCIAL OPERATIONS AND ARRANGEMENTS
OF PUBLIC AND PRIVATE CORPORATIONS

CHAPTER I.

GENERAL POWER TO INCUR PECUNIARY LIABILITY — PUBLIC CORPORATIONS.

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SECTION 1. **General rules applicable to public corporations.** —All public corporations are limited to the exercise of those powers which are expressly granted or which are necessarily or fairly implied in or incident to the powers expressly granted, or which are essential to the declared objects and purposes of such corporations.[1] Corporations and their officers can only act within the scope of the powers conferred by their charters, and such powers are to be construed strictly.[2] A municipal corporation has no general authority to exchange promises with other corporations or persons; its contracts to be valid, must be within the scope of the authority conferred upon it by law and for municipal purposes.[1] A municipal corporation, as a general rule, cannot incur any liability not authorized by the statute or charter by which it is created.[2] Counties, in the absence of legislative authority, have no power to borrow money and execute their obligations for the loan, notwithstanding a purpose to apply the money to the use of the public.[3] The statutory grant in Kansas to county commissioners to borrow money to meet current expenses, when a deficit exists in the county revenue, only authorizes a borrowing when the deficit has actually occurred.[4]

[1] Town of Harwood *v.* Hamilton, (1883) 13 Bradw. 358; Cook County *v.* McCrea, 93 Ill. 236; People *v.* Village of Crotty, 93 Ill. 180; Petersburg *v.* Metzker, 21 Ill. 205; Schott *v.* People, 89 Ill. 195. In Law *v.* People, (1877) 87 Ill. 385, the Supreme Court of Illinois said upon the power of municipal corporations: "The law is, and all persons are presumed to know it, that municipal bodies can only exercise such powers as are conferred upon them by their charters, and all persons dealing with them must see that the body has power to perform the proposed act. Such corporations are created for governmental and not for commercial purposes. Hence power to borrow money or create indebtedness is not an incident to such local governments, and the power cannot be exercised unless it is conferred by their charter, and no one has the right to presume the existence of such power, and persons proposing to loan money to these bodies must see that the power exists."

[2] Minturn *v.* Larue, 23 How. 435; Thomson *v.* Lee County, 3 Wall. 327; Thomas *v.* City of Richmond, 12 Wall. 349; Clark *v.* Davenport, 14 Iowa, 494; Merriam *v.* Moody's Exrs., 25 Iowa, 163; Nichol *v.* Mayor, etc., 9 Humph. 252; Leonard *v.* Canton, 35 Miss. 189; Douglass *v.* Placerville, 18 Cal. 643; Argenti *v.* San Francisco, 16 Cal. 255, 282; Wallace *v.* San José, 29 Cal. 180; City of Lafayette *v.* Cox, 5 Ind. 38; Bank *v.* Chillicothe, 7 Ohio, 31, pt. II; Collins *v.* Hatch, 18 Ohio, 523; Kyle *v.* Malin, 8 Ind. 34; Willard *v.* Killingworth, 8 Conn. 247; Brady *v.* Mayor, etc., 20 N. Y. 312; Hodges *v.* Buffalo, 2 Denio, 110; Halstead *v.* Mayor, etc., 3 N. Y. 430; Boom *v.* Utica, 2 Barb. 104.

[1] COOLEY, J., in Thomas *v.* City of Port Huron, (1873) 27 Mich. 320

[2] Wheeler *v.* County of Wayne, (1890) 132 Ill. 599; s. c., 24 N. E. Rep. 625, affg. 31 Ill. App. 299; Cook County *v.* McCrea, 93 Ill. 236; City of Champaign *v.* Harmon, 98 Ill. 491; Schott *v.* People, 89 Ill. 195; People *v.* Village of Crotty, 93 Ill. 180.

[3] Crittenden County Court *v.* Shanks, (1889) 88 Ky. 475; s. c., 11 S. W. Rep. 468.

[4] Lewis *v.* Comanche County, 35 Fed. Rep. 343.

§ 2. **Distinction between public and private corporations.** — Political corporations, in their organization and purposes, are essentially different from private corporations. The former are created to aid in the government of the people, the latter to promote trade, manufactures and a variety of other interests. Private corporations are usually endowed with all the powers and rights of an individual, so far as they can be conferred. And the power to contract debts and to issue evidences of the same is an incident equally attending their creation. When authorized to perform an act, unless restricted by the charter, they may employ the means and perform the act in the same manner that might be done by a private individual. This is necessarily so to effectuate the purpose of their foundation with most private corporations. Municipal corporations, however, being created for purposes of government, and authorized as it were to exercise, to a limited extent, a portion of the power of the state government, have

always been held to act strictly within their charter. It is to them their fundamental law, and their power is only co-extensive with the power granted. Not being essential to the purposes and object of their creation, without an express grant of power for the purpose, they have no authority to contract debts, binding upon the body or individual residing within their limits. Such a power being unusual when they are created, and usually being conferred, if at all, by special enactment, and all persons familiar with the fact, it is but natural that those who deal with them, or in their obligations, should see to it that the body possesses the power to bind itself for their payment. On the other hand, the object of private corporations usually renders it necessary that they should transact such business as may involve the necessity of incurring debt.

§ 3. Borrowing money.— In a case arising in Ohio, frequently cited as authority, the Supreme Court of that state held that a town corporation, invested with the powers usually conferred upon such bodies, could enter into a contract for a loan of money to be used by the town, which would bind the corporation for repayment, although no express power to borrow money be given in the law incorporating the town.[1] The court upheld the

[1] President, etc., Bank of Chillicothe *v.* Mayor, etc., Town of Chillicothe, (1836) 7 Ohio (Pt. II) 31. It was said by HITCHCOCK, J., delivering the opinion for the court, after referring to certain provisions in the charter of the town: "From these extracts it will be seen that this corporation, as by that law constituted, had legislative power; this power, it is true was restricted to such powers as should seem necessary for the internal safety and convenience of said town of Chillicothe, and restricted, too, so far that the laws made and published should not be contrary to the laws of the state or of the United States. It had the power further 'to purchase, receive, possess and convey any real or personal estate for the use of the town, to erect and repair public buildings for the benefit of said town,' etc. If the power to borrow money be, as is insisted by counsel, a *substantial legislative power*, or, according to my apprehension of the subject, an incident to legislative power, and, if it became necessary for the safety and convenience of the town, or to carry into effect the power granted to purchase real or personal estate, or to erect or repair public buildings, to borrow money, there could be no objection to passing a law or ordinance to that effect. When passed, it would be obligatory on the corporation, and the money procured would constitute a debt which the corporation must discharge. Such law would contravene no principle of the Constitution or laws of the state or of the United States, or any principle contained in the charter of incorporation. To effect other subjects [objects?] than those specified in the charter, money could not with propriety be borrowed * * * An amendment to the charter conferred upon the mayor and common council the power to pass and publish all such laws and ordinances as to them shall appear necessary for regulating the streets, alleys and highways, and for cleansing, raising, draining, paving, turnpiking or otherwise keeping the same in repair. * * * If, in effecting any of these objects, it become necessary to borrow money, the corporation might with propriety do it. In one of the cases now before the court the money was borrowed expressly for improving one of the streets. For the purpose of purchasing real estate, erecting and repairing public buildings, cleansing, raising, paving, draining, turnpiking and otherwise keeping streets in repair contracts must necessarily be made. Ultimate payment, it is true, must be made from taxation. But until money could be thus raised it seems to the court that it might be provided otherwise, and in no way better than by borrowing. And really, I cannot see the great difference whether a corporation shall be indebted to A. for labor in repairing streets or buildings, or to B. for money borrowed to pay A. for the same labor. The moral obligation to pay would be the same in either case."

power of the corporation to borrow money as incident to the powers expressly granted in the charter of the town. But a municipal corporation in Ohio has no power to borrow money except in conformity with the statute of that state, which provides that "all bonds issued under authority of this chapter shall express upon their face the purpose for which they were issued, and under what ordinance," and another statutory provision that such bonds shall be advertised and sold at auction to the highest bidder.[1]

§ 4. The United States Supreme Court on borrowing money.— A majority of the Supreme Court of the United States has held that the power to borrow money does not belong to a municipal corporation as an incident of its creation. To be possessed, it must be conferred by legislation either express or implied. Indebtedness may be incurred to a limited extent in carrying out the objects of the incorporation. For its payment, however, the corporation must look to and rely on taxation, the legitimate mode of raising the funds for the purpose.[2]

[1] Mt. Adams, etc., Inclined Ry. Co. *v.* City of Cincinnati, 25 Wkly. Law Bull. 91; Rev. St. Ohio, §§ 2703, 2709.

[2] Mayor *v.* Ray, (1873) 19 Wall. 468. Justice BRADLEY in the opinion rendered by him for the majority of the court, said: "A municipal corporation is a subordinate branch of the domestic government of a state. It is instituted for public purposes only; and has none of the peculiar qualities and characteristics of a trading corporation, instituted for purposes of private gain, except that of acting in a corporate capacity. Its objects, its responsibilities, and its powers are different. As a local governmental institution it exists for the benefit of

§ 5. The New Jersey Court of Errors and Appeals on borrowing money.— Soon after this ruling of the Supreme Court of the United States, the Court of Errors and Appeals of New Jersey held that municipal corporations, in the absence of a specific grant of power, do not, in general, possess the power of borrowing money, and that a note given by a town in New Jersey for an unauthorized loan could not be enforced, even though the money borrowed had been expended for municipal purposes.[1]

the people within its corporate limits. The legislature invests it with such powers as it deems adequate to the ends to be accomplished. The power of taxation is usually conferred for the purpose of enabling it to raise the necessary funds to carry on the city government and to make such public improvements as it is authorized to make. As this is a power which immediately affects the entire constituency of the municipal body which exercises it, no evil consequences are likely to ensue from its being conferred; although it is not unusual to affix limits to its exercise for any single year. The power to borrow money is different; when this is exercised the citizens are immediately affected only by the benefit arising from the loan; its burden is not felt till afterwards. * * * The system of local and municipal government is copied in its general features from that of England. No evidence is adduced to show that the practice of borrowing money has been used by the cities and towns of that country without an act of Parliament authorizing it. We believe no such practice has ever obtained." See Wells *v.* Town of Salina, 119 N. Y. 280; s. c., 23 N. E. Rep. 870.

[1] Town of Hackettstown *v.* Swackhamer, (1874) 37 N. J. Law, 191. BEASLEY, Ch. J., in an elaborate opinion, discussed the question in the following language: "At the present time it seems to be generally conceded that a private corporation, constructed with a view to pecuniary profit, has, by implication, when not in this particular specially restricted, the power in question. The law was so held in this state, in the case of Lucas *v.* Pitney, 27 N. J. Law, 221, and the same rule has been repeatedly recognized in other decisions. And this result is the appropriate product of the principle that corporate powers which are the necessary accompaniments of powers conferred, will be implied. In these instances the ability to borrow money is so essential that without it the business authorized could not be conducted with reasonable efficiency, and as it cannot be supposed that it was the legislative intent to leave the company in so imperfect a condition, the inference is properly drawn that the power to raise money in this mode is inherent in the very constitution of such corporate bodies. Such a deduction is simply, in effect, a conclusion that the lawmaker designed to authorize the use of the means fitted to accomplish the purpose in view. It has been often said that the means which can be thus raised up by implication must be necessary to the successful prosecution of the enterprise, and that the circumstance that they are convenient will not deputize their introduction. But the necessity here spoken of does not denote absolute indispensableness, but that the power in question is so essential that its non-existence would render the privileges granted practically inoperative or incomplete.

§ 6. Issue of negotiable securities.—A majority of the Supreme Court of the United States, while conceding that vouchers for money due, certificates of indebtedness for services rendered or for property furnished for the uses of a municipality, orders or drafts drawn by one city officer upon another, or any other device of the kind used for liquidating the amounts legitimately due to public creditors, are, of course, necessary instruments for carrying on the machinery of municipal administration and for anticipating the collection of taxes, looked upon the investing of such documents with the character and incidents of commercial paper so as to render them in the hands of *bona fide* holders absolute obligations to pay, however irregularly or fraud-

It is consequently obvious that a presumption, resting on such a basis as this, must spring up in favor of almost the entire mass of commercial and manufacturing corporations, for without the franchise to effect loans the chartered business could be but imperfectly transacted. And, yet, even in such instances, the usual inference that such an implied power exists may be repelled by the language of the particular charter or the peculiar circumstances of the case. In a word, the rule of law in question is nothing but the discovery, by the courts, of the legislative intent, such intent having been ascertained by a construction of charters, as applied to the subject-matters. Taking this as the ground of our reasoning I am at a loss to perceive how it can be inferred that a power to borrow money is an appendage to the usual franchises given to municipal corporations. Such a right cannot, in any reasonable sense, be said to be necessary within the meaning of that term as already defined. Under ordinary circumstances it is not certainly indispensable as common experience demonstrates. In the great majority of instances the municipal affairs are, with ease and completeness, transacted without it. I do not wish to be understood as indicating that under certain special conditions an opposite deduction may not be legitimately drawn. It is plain that it is practicable to impose a duty on a municipality requiring the immediate use of sums of money, and in such a situation the inference may become irresistible that it was intended that funds were to be provided by loans. My remarks are to be restricted to that class of cases where charters are granted containing nothing more than the usual franchises incident to municipal corporations, and under such conditions it seems clear to me that the power to borrow money is not to be deduced. I have already said that it does not appear to be a necessary incident to the powers granted, for such powers can be readily and efficiently executed in its absence. It would be to fly in the face of all experience to claim that the ordinary municipal operations cannot be efficiently carried on except with the assistance of borrowed capital. Without any help of this kind, it is well known that our towns and cities have long been, and are now being, improved and governed. For the attainment of these ends it has not generally been found necessary to resort to loans of money. The supplies derived annually from taxation have

ulently issued, as an abuse of their true character and purpose; as having the effect of converting a municipal organization into a trading company and putting it in the power of corrupt officials to involve a political community in irretrievable bankruptcy. They held that no such power legally existed, unless conferred by legislative enactment, either express or clearly implied.[1] The

been found amply sufficient for these purposes. Consequently I am unable to perceive any necessity to borrow money, under these conditions, from which the gift of such power to borrow is to be implied. It undoubtedly is clear that if, as has been asserted, the ends of the municipal charter can be conveniently reached, without a resort to the device of raising money by loan, there is not the least legal basis for a claim of the power to obtain funds in that way. Granted the fact that the charter can be executed with reasonable ease and with completeness, the conclusion is inevitable that the power in question cannot be called into existence by intendment, and, as I claim the fact to exist, I must, of necessity, reject the right of implication in question."

[1] Mayor *v.* Ray, (1873) 19 Wall. 468. Mr. Justice BRADLEY, in the opinion delivered by him, said: "There are cases, undoubtedly, in which it is proper and desirable that a limited power of this kind should be conferred, as where some extensive public work is to be performed, the expense of which is beyond the immediate resources of reasonable taxation, and capable of being fairly and justly spread over an extended period of time. Such cases, however, belong to the exercise of legislative discretion, and are to be governed and regulated thereby. Where the power is clearly given, and securities have been issued in conformity therewith, they will stand on the same basis and be entitled to the same privileges as public securities and commercial paper generally. But where the power has not been given, parties must take municipal orders, drafts, certificates and other documents of this sort at their peril. Custom and usage may have so far assimilated them to regular commercial paper as to make them negotiable; that is, transferable by delivery or indorsement. This quality renders them more convenient for the purposes of the holder, and has undoubtedly led to the idea subsequently, but, we think, erroneously, entertained, that they are invested with that other characteristic of commercial paper — freedom from all legal and equitable defenses in the hands of a *bona fide* holder. But every holder of a city order or certificate knows that to be valid and genuine at all it must have been issued as a voucher for city indebtedness. It could not be lawfully issued for any other purpose. He must take it, therefore, subject to the risk that it has been lawfully and properly issued. His claim to be a *bona fide* holder will always be subject to this qualification. The face of the paper is notice to him that its validity depends upon the regularity of its issue. The officers of the city have no authority to issue it for any illegal or improper purpose; another's acts cannot create an estoppel against the city itself, its taxpayers, or people. Persons receiving it from them know whether it is issued and whether they receive it for a proper purpose and a proper consideration. Of course, they are affected by the absence of these essential ingredients, and all subsequent

Supreme Court of Louisiana has held that, in the absence of express legislative authority, a municipal corporation has no power to utter unconditional obligations to pay money. Such a corporation may, however, issue evidences of liability for consideration received for ultimate payment, depending upon contingencies which must have happened before any right of action can accrue.[1]

holders take *cum onere* and are affected by the same defect. Much less can any precedent be found (except of modern date and in this country) for the issue, by local civil authorities, of promissory notes, bills of exchange and other commercial paper. At a period within the memory of man the proposal of such a thing would have been met with astonishment. The making of such paper was originally confined to merchants. But its great convenience was the means of extending its use, first, to all individuals, and afterwards to private corporations having occasion to make promises to pay money. Being only themselves responsible for the paper they issue, no evil consequences can follow sufficient to counterbalance the conveniences and benefits derived from its use. They know its immunity in the hands of a *bona fide* holder from all defenses and equities. Knowing this, if they choose to issue it, no one is injured but themselves. But if city and town officials should have the power thus to bind their constituencies it is easy to see what abuses might and probably would ensue. We know from experience what abuses have been practiced where the power has been conferred. Fraudulent issues, peculations and embezzlements and the accumulation of vast amounts of indebtedness without any corresponding public benefit have been rendered easy and secure from merited punishment. The purpose and object of a municipal corporation do not ordinarily require the exercise of any such power. They are not trading corporations and ought not to become such. They are invested with public trusts of a governmental and administrative character; they are the local governments of the people, established by them as their representatives in the management and administration of municipal affairs affecting the peace, good order and general well-being of the community as a political society and district, and invested with power by taxation to raise the revenues necessary for those purposes. The idea that they have the incidental power to issue an unlimited amount of obligations of such a character as to be irretrievably binding on the people, without a shadow of consideration in return, is the growth of a modern misconception of their true object and character. If, in the exercise of their important trusts, the power to borrow money and to issue bonds or other commercial securities is needed, the legislature can easily confer it under the proper limitations and restraints, and with proper provision for future repayment. Without such authority it cannot be legally exercised. It is too dangerous a power to be exercised by all municipal bodies indiscriminately, managed as they are by persons whose individual responsibility is not at stake."

[1] Newgass *v.* City of New Orleans, (1890) 42 La. Ann. 163; s. c., 7 So. Rep. 565. That a municipal corporation has not an incidental or implied power to make or issue negotiable paper, see New Orleans, M. & C. R. R. Co. *v.* Dunn, 51 Ala. 128; Blackman *v.* Lehman, 63 Ala. 547.

§ 7. Power of Indiana cities to issue bonds.— A city in Indiana has power, under a charter authorizing it "to borrow money for the use of the city," to issue bonds for money so borrowed.[1]

§ 8. Miscellaneous rules as to issuing bonds.— Municipal corporations in which power is vested by legislative grant to make expenditures for purposes of a certain kind, unless prohibited by law, may make contracts for the accomplishment of those purposes, thereby incur indebtedness and issue proper evidences of indebtedness in payment for the same.[2] A county in Kansas has power to borrow money for the erection of county buildings, and to issue its bonds for the money borrowed.[3] The officials of a municipal corporation, which is vested with the usual power of such bodies, are authorized to issue bonds or promissory notes to

[1] City of Evansville *v.* Woodbury, (1894) 60 Fed. Rep. 718; s. c., 9 C. C. A. 244, following Railroad Co. *v.* Evansville, 15 Ind. 395, which adopted the following from Slack *v.* Railroad Co., 13 B. Mon. (Ky.) 1, to wit: "Moreover, the first act under which the debt was created gave full power to the County Court to provide for its payment either by taxation or by borrowing the money, which, of course, implied the power, as it did the necessity, of furnishing some evidence of indebtedness, another court might doubtless have issued the bonds of the county in some form to the lender." In City of Evansville *v.* Woodbury, *supra*, the United States Circuit Court of Appeals, speaking through SEAMAN, D. J., had this to say as to the rule declared in the text: "The borrowing of money to pay outstanding indebtedness of the city was clearly a borrowing for the use of the city; and if this ruling (in Railroad Co. *v.* Evansville, *supra*) must govern here, the power to issue the bonds is well shown. That decision appears to have remained undisturbed, and is in accord with the doctrine constantly held by that court. Dill. on Mun. Corp. § 119. It is worthy of note that the Supreme Court of the United States held directly the same construction upon a grant of power 'to borrow money for any public purpose' in Rogers *v.* Burlington, 3 Wall. 654, and Mitchell *v.* Burlington, 4 Wall. 270. These decisions were five and six years after that in Indiana; and although they appear to have been overruled in recent years, they would constitute some justification, if any were needed, for reliance by purchasers upon the Indiana interpretation. The federal courts have maintained a rule from their organization that in all cases depending upon a state statute, they will adopt and follow the adjudications of the court of last resort in its construction, when that construction is well settled, and without injury as to its original soundness. * * * Therefore, the recent decisions in Merrill *v.* Monticello, 138 U. S. 673; s. c., 11 Sup. Ct. Rep. 441, and Brenham v. Bank, 144 U. S. 173; s. c., 12 Sup. Ct. Rep. 559, * * * are not applicable."

[2] Police Jury *v.* Britton, 15 Wall. 566.

[3] Comanche County *v.* Lewis, 133 U. S. 198.

evidence the credit price of any works for which they are authorized to contract, which in the hands of a *bona fide* holder, will be protected by the law merchant.[1] A city, by the issue of its bonds according to law, having created a debt against itself, has power, like any other debtor, to enter into negotiations concerning such bonds, and to have them delivered up for cancellation and new bonds issued in exchange for them, without any special grant of authority therefor.[2] The charter of a city empowering it "to borrow, on the credit of the city, a sum of money not exceeding [a sum named]; to issue bonds, scrip, or certificates of indebtedness therefor," etc., with a provision that "with the money so borrowed the city council shall first liquidate and discharge all legal indebtedness of the city," may issue such bonds as they deem proper within the terms of the charter, and with the proceeds take up the floating indebtedness of the corporation.[3] Towns in Maine must be expressly or impliedly authorized by statute, or they cannot borrow money and issue notes of a commercial character for the execution of their ordinary business.[4] The governing powers of counties are not authorized by the statutes of Illinois which empower them "to make all contracts and do all other acts necessary to the exercise of its corporate powers," and "to manage the county funds and county business, except as otherwise specifically provided," to issue bonds without a vote of the people.[5] A grant of authority to a municipal corporation to issue "refunding bonds" or original bonds to procure money for use in the "legitimate exercise of the corporate powers," and for the payment of legitimate corporate debts does not carry with it power to issue bonds to replace in the treasury money already used in paying prior bonds.[6] A municipal corporation having statutory power to issue bonds for loans lawfully made has, by necessary implication, also

[1] Holmes *v.* City of Shreveport, (1887) 31 Fed. Rep. 113, in which case the bonds sued upon were issued for public improvements. As to authority of corporations to give notes to evidence indebtedness, see Brode *v.* Firemen's Ins. Co., 8 Rob. (La.) 244; Edey *v.* City of Shreveport, 26 La. Ann 636; City of Shreveport *v.* Flournoy, 26 La. Ann. 709; Desmond v. Jefferson, 19 Fed. Rep. 483.

[2] Rogan *v.* City of Watertown, (1872) 30 Wis. 259.

[3] City of East St. Louis *v.* Maxwell, (1881) 99 Ill. 439.

[4] Parsons *v.* Monmouth, 70 Me. 262.

[5] Locke *v.* Davison, 111 Ill. 19. As to authority to issue bonds, see Bannock County *v.* Bunting, (Idaho) 37 Pac. Rep. 277; Hotchkiss *v.* Marion, 12 Mont. 218.

[6] Coffin *v.* City of Indianapolis, (1894) 59 Fed. Rep. 221.

the power to make the bonds negotiable.[1] A County Court in Missouri with statutory authority to make bonds issued for the purpose of improving public roads transferable in such manner as by its order it might direct, may issue negotiable bonds; and this may be done by the issue of such bonds, without an order prescribing their form.[2] And under the statutory authority to issue bonds to pay for improving public roads, and "building culverts and bridges to secure permanent and good roads," the county may issue bonds to pay for riprapping around the abutment of a bridge to prevent its becoming a wreck.[3] Under the laws of Washington giving municipal corporations authority to provide means for constructing works of public utility by issuing and selling negotiable bonds there is authority to make such bonds payable in gold coin of the present standard weight and fineness.[4] Municipal corporations may issue new bonds with coupons for future interest for the purpose of funding debts, with accrued interest existing prior to the adoption of the amendment of the State Constitution of Indiana prohibiting municipal corporations from becoming indebted to an amount in the aggregate exceeding two per centum on the value of their taxable property, and providing that all obligations in excess of such amount shall be void, as the amendment is only prospective in its operation.[5]

[1] City of Cadillac *v.* Woonsocket Inst. for Savings, (1893) 58 Fed. Rep. 935; s. c., 7 C. C. A. 574; LURTON, Ch. J., said: "The case of Brenham *v.* Bank, 144 U. S. 173; s. c., 12 Sup. Ct. Rep. 559, has no bearing upon this question. Nothing more is there decided than that an act empowering a city to "borrow for general purposes not exceeding $15,000 on the credit of the city" did not authorize the issuance of negotiable obligations for the money so borrowed.

[2] Catron *v.* LaFayette County, 106 Mo. 659; s. c., 17 S. W. Rep. 577.

[3] Ibid. As to the power of counties to issue negotiable securities, see Francis *v.* Howard County, 50 Fed. Rep. 44, following Nolan County *v.* State, 83 Tex. 182; s. c., 17 S. W. Rep. 823; Robertson *v.* Breedlove, 61 Tex. 316. As to a limitation upon the issue of bonds, see Francis *v.* Howard County, 50 Fed. Rep. 44, following Russell *v.* Cage, 66 Tex. 428; s. c., 1 S. W. Rep. 270.

[4] Moore *v.* City of Walla Walla, (1894) 60 Fed. Rep. 961.

[5] Powell *v.* City of Madison, (1886) 107 Ind. 106. The court said: "The issuing of new bonds to provide, at their par value, for the payment of an old debt or the substitution of new evidences of a pre-existing debt, is not, in any legal or proper sense, the creation of a new indebtedness. Nor is the funding of interest already due, or the execution of coupons for the payment of interest which will thereafter accrue upon a pre-existing indebtedness, either the creation of a new debt, or, in legal contemplation, an increase of such pre-existing indebtedness."

§ 9. Bonds issued for the erection of a county court house.— A statute authorizing the electors of a county to empower the commissioners of such county to "borrow money" for the erection of a court house does not authorize them to empower such commissioners to issue bonds for that purpose.[1] The authority to issue bonds as an evidence of indebtedness might perhaps follow as an incident of the right to borrow money, but in that case the amount of money borrowed should equal the amount for which the bonds call. There is no right to issue them and sell them for what they will bring.[2] County warrants issued for the purpose of erecting a county court house in Nebraska have been held void where their issue was not authorized by a vote of the qualified electors of the county, and no benefit whatever resulted to the county from the issuing of such warrants.[3]

§ 10. Funding county indebtedness by issuing interest-bearing bonds.—There is no authority of law for a county board in Illinois to fund county indebtedness or issue interest-bearing bonds for money with which to take up outstanding county orders and obligations without a vote of a majority of the legal voters of the county; and such a vote having been obtained, the interest on the bonds is limited to eight per cent. Such boards are not given by the statute which provides that they shall have power "to manage county funds and county business, except as otherwise specially provided," an absolute and unlim-

[1] Lewis *v.* Board of County Commissioners of Sherman County, (1881) 2 McCrary, 464, holding certain bonds issued by the commissioners for erecting a court house invalid, on the following grounds: Because of the lack of statutory authority to vote for such bonds; because no bonds had ever been voted for any such purposes; because none of the bonds or the proceeds thereof were ever used to build a court house or were ever used for any other purpose by the county; and because the bonds contained no recitals showing that they had been issued conformably to law. Certain bridge bonds issued by the county, reciting that they were issued conformably to law, were, however, held valid in the hands of an innocent purchaser for value in open market, the bridges having been built in the county by direction of the county, for the county, and having been paid for by such bonds or their proceeds, although they were not in fact authorized by the vote of the people as the law required.

[2] Lewis *v.* Board of County Commissioners of Sherman County, (1881) 2 McCrary, 464, supported by Scipio *v.* Wright, 101 U. S. 665.

[3] Brown *v.* Board of County Commissioners of Sherman County, (1881) 2 McCrary, 469.

ited power of management of county funds, there being an absence of any specific provision of law to the contrary.[1]

§ 11. Issue of bonds to pay subscriptions to stock of railroad corporations.—There has not been uniformity in the decisions of the state and federal courts as to whether or not the grant of legislative authority to subscribe carried with it as an incident the power to issue bonds in payment of the subscriptions. The Supreme Court of Connecticut, at an early date, held that a city empowered to subscribe to the stock of a railroad corporation and to effect loans of money as a means of paying its subscriptions, upon the proper vote of its tax-paying citizens, had authority to issue its bonds to the railroad corporation in payment of such subscriptions;[2] this upon the established principle in the law of corporations, that they may exercise all the powers within the fair intent and purpose of their creation which are reasonably proper to give effect to powers expressly granted.[3] The following are the views entertained by the Supreme Court of Pennsylvania: The power given a municipal corporation to

[1] Locke *v.* Davison, (1884) 111 Ill. 19, affirming a decree granting an injunction against the payment of ten per cent interest on the funding bonds issued by this county board; following County of Hardin *v.* McFarlan, (1876) 82 Ill. 138, holding that under the act which enabled counties to liquidate their debts, providing that the County Courts or boards of supervisors might levy a special county tax for that purpose, those debts could be discharged by the levy of such tax, and the county board had no authority to take up its outstanding orders and give bonds in lieu thereof, bearing interest, as such obligations could not be issued in the absence of statutory authority. The court in this case distinguished City of Galena *v.* Corwith, 48 Ill. 423, in that "the decision in that case was based upon the ground that the city, by its charter, had power to borrow money, and not having been restricted as to the means of exercising this power, could issue the bonds." They further said; "It was held in Commissioners of Highways *v.* Newell, 80 Ill. 587, that more was said in that case than the subject justified, and that it needed modification confining it to cases where the charter of the corporation expressly grants a power, for a corporation cannot exercise any powers save those granted or necessarily implied in order to carry into effect a granted power." Upon the subject of contracting for interest on the part of counties, see also Madison County *v.* Bartlett, 1 Scam. (Ill.) 67; County of Pike *v.* Hosford, 11 Ill. 170; Hall *v.* Jackson County, 95 Ill. 352; County of Jackson *v.* Rendleman, 100 Ill. 379.

[2] City of Bridgeport *v.* Housatonuc R. R. Co., (1843) 15 Conn. 475.

[3] Seybert *v.* City of Pittsburg, 1 Wall. 272; R. R. Co. *v.* County of Otoe, 16 Wall. 667; Evansville, etc., R. R. Co. *v.* City of Evansville, 15 Ind. 395.

subscribe for stock of a railroad company gives the power to create a debt, and to give an evidence of it. The power to execute and issue bonds, contracts or other certificates of indebtedness belongs to all corporations, public as well as private, and is inseparable from their existence. For a legal and authorized debt a municipal corporation may give its bond under its general corporate powers. A municipal bond in payment of a subscription to stock of a railroad company, if invalid, is so, not because the corporation has no power to issue bonds, but because the subscription to the stock is outside of the power of the corporation; and when a city has been authorized to make such a subscription by the legislature it becomes a debt like any other, and may be evidenced in the same way. Bonds issued in payment of the debt are valid obligations of the corporation.[1] The Supreme Court of the United States has held to the doctrine that grants of power to municipal corporations to subscribe for stock in railways should be construed strictly and not be extended beyond the terms of the statute; and as there is no power in a municipal corporation to become a stockholder in a railroad corporation unless expressly conferred by the legislature, the power to issue negotiable bonds to pay such a subscription must be expressly, or by reasonable implication, conferred by statute.[2] Neither is the issuing of negotiable bonds authorized by a grant to a municipal corporation of power to appropriate moneys in aid of construction of a railroad, directing levy and collections of taxes to meet such appropriation, and prescribing no other mode of payment.[3] Considering the difference of opinion existing in these two jurisdictions upon this question, it seems that it would be well for the legislature hereafter in granting powers to municipal corporations to aid in the construction of public works by subscription to the stock of the corporations organized for the purpose, to expressly include the power to issue negotiable bonds for the payment of such subscriptions.

[1] Commonwealth ex rel. Reinboth *v.* Councils of Pittsburgh, (1861) 41 Pa. St. 278.

[2] Kelley *v.* Milan, 127 U. S. 139, affirming Kelley *v.* Town of Milan, 21 Fed. Rep. 842; Norton *v.* Dyersburg, 127 U. S. 160; Young *v.* Clarendon, 132 U. S. 340; Hill *v.* Memphis, 134 U. S. 198.

[3] Concord *v.* Robinson, 121 U. S. 165. See, also, Scott's Exrs. *v.* Shreveport, 20 Fed. Rep. 714; Katzenberger *v.* City of Aberdeen, 16 Fed. Rep. 745; Board of Comrs. of Delaware County *v.* McClintock, Auditor, (1875) 51 Ind. 325; La Fayette, M. & B. R. R. Co. *v.* Geiger, 34 Ind. 185; Harney *v.* Indianapolis, C. & D. R. R. Co., 32 Ind. 244.

§ 12. Notes or warrants to cover funds to be set aside in future taxation.— The Supreme Court of Louisiana has held that the police juries, the governing boards of the parishes in that state, have the undoubted authority to construct bridges, repair the same and to open roads and to keep the same in order. But they have no power to contract an indebtedness for this purpose in advance and to issue promissory notes or warrants to cover funds which may be set aside for this purpose in future taxation without express authority from the supreme political power of the state.[1]

§ 13. The issue of scrip.— Under a statute authorizing the city council to issue scrip to a certain amount, bearing interest at a rate not exceeding six per cent per annum, and providing that the statute should be void unless approved by a majority of the voters of the city present and voting at meetings held on a certain day, the council issued and sold scrip with principal and interest payable in coin. A statute enacted afterwards authorized the city to contract for the payment in coin of the principal and interest of this scrip and ratified all acts of the city or any officer in the matter of making payment in coin of this scrip, not providing for any new submission of the matter to the voters of the city. The issue of the scrip as it had been issued payable in coin was held to be legal.[2] And a city authorized, for the purpose of defraying the expense of a public work, to issue scrip may lawfully issue the same all at once, and invest the money not required for immediate use upon the work in United States securities.[1] The issue of change bills or promises in the similitude of currency are prohibited in Georgia by statute, and no recovery can be had upon such change bills issued by a city.[2]

[1] Snelling *v.* Joffrion, President Police Jury, (1890) 42 La. Ann. 886; s. c., 8 So. Rep. 609, in which case the court affirmed the judgment in favor of the taxpayers who brought the action to annul the ordinance of the police jury authorizing the giving of ten notes of equal amounts payable one in each of the ten years to come from the date, to a bridge company which had contracted to build the bridge. The court said, however: "We do not mean to say that police juries cannot contract for improvements which they are authorized to make, to be paid out of the taxes which they are authorized to levy for parochial expenses, and which are set apart for this special improvement, but they cannot issue any promissory note, draft or warrant in advance to cover this amount which may go into the treasury. It must be there before the warrant issues, unless by legislative authority they are authorized to issue the same in advance. Sterling *v.* Parish of West Feliciana, 26 La. Ann. 59."

[2] Foote *v.* City of Salem, (1867) 14 Allen, 87, Bigelow, Ch. J., said: "It was clearly competent for the legislature to grant such power and to give validity to contracts into which the city had entered without the requisite legislative authority. No legal or constitutional right, either public or private, was violated by such enactment."

§ 14. Purchase of real estate for erection of public buildings on time.— The statutes of Indiana[3] conferring on cities the general power, with restrictions, to purchase real estate, for the purpose of constructing public buildings thereon, by implication, gives the exclusive right to determine the expediency of the purchase, the power to purchase on credit and to issue negotiable bonds of the city for the purchase money.[4] And the purchase of real estate by a city for construction of public buildings thereon on a credit of ten years is not a loan within the meaning of the Indiana statute,[5] prescribing that "loans may be made by a vote of two-thirds of the council, in anticipation of the revenue of the current and following year, and payable within that period; but the aggregate amount of such loan in any fiscal year shall not exceed the levy and tax authorized by this act for municipal expenses," and is not prohibited by that statute.[6]

[1] Foote *v.* City of Salem, (1867) 14 Allen, 87.

[2] Cothran *v.* City of Rome, 77 Ga. 582.

[3] Ind. R. S. 1881, § 3106, clause 4.

[4] City of Richmond *v.* McGirr, (1881) 78 Ind. 192. That courts cannot interfere with the exercise by governing authorities of their discretion in such matters, as a general rule, see Kelley *v.* City of Milwaukee, 18 Wis. 83; Baker *v.* Boston, 12 Pick. 184; Ex parte Fay, 15 Pick. 243; Parks *v.* Boston, 8 Pick. 218; Benjamin *v.* Wheeler, 8 Gray, 409; Evansville, etc., R. R. Co. *v.* City of Evansville, 15 Ind. 395; Macy *v.* City of Indianapolis, 17 Ind. 267; City of Greencastle *v.* Hazelett, 23 Ind. 186; Brinkmeyer *v.* City of Evansville, 29 Ind. 187.

[5] Ind. R. S. 1881, § 3159.

[6] City of Richmond *v.* McGirr, (1881) 78 Ind. 192. As to the distinction between a transaction like this and borrowing money, the court referred to Gelpcke *v.* City of Dubuque, 1 Wall. 175, 221, where it was held that the execution of bonds to pay an existing indebtedness of the city was not within the prohibition of the charter against the borrowing of money, and distinguished Mayor, etc., of Baltimore *v.* Gill, 31 Md. 375, and Jonas *v.* City of Cincinnati, 18 Ohio, 318. There was a limitation in the charter of this city upon the borrowing of money, but no restriction upon the creation of indebtedness. The court said: "The charter expressly grants to the council the power to purchase the real estate; * * * and in the absence of any statutory mode being pointed out for the exercise of such power, it may contract with reference to such power as a natural person; and such power is implied from the general unlimited

§ 15. Erection of town buildings.— As incident to its power to build a town house, a town has a right, in its discretion, to make additional compensation to a person for labor done by him in building it as a contractor under another person with whom the town had contracted to build it for a fixed sum.[1] The Massachusetts statute authorizing towns and cities to establish public libraries and in so doing to "appropriate money for suitable buildings or rooms" and for "the foundation of a library a sum not exceeding one dollar for each of its votable polls" has been construed, and the court determined that the words "not exceeding" did not necessarily qualify and limit the entire first clause; that on the contrary they were intended to restrict the latter provision with which they were immediately connected; that the intention of the legislature was to put a precise limit on the sum to be expended for books, and not on that to be appropriated for buildings or rooms.[2]

power granted. This rule, we think, arises from the necessity of the case, and is in harmony with the general rule of the law as established by the authorities. Citing Ketchum *v.* City of Buffalo, 14 N. Y. 356; Brady *v.* Mayor, etc., Brooklyn, 1 Barb. 584; Halstead *v.* Mayor, etc., New York, 5 Barb. 218; Mott *v.* Hicks, 1 Cow. 513; Moss *v.* Oakley, 2 Hill, 265; Kelley *v.* Mayor, etc., Brooklyn, 4 Hill, 263; Field on Corp. § 271; City of Galena *v.* Corwith, 48 Ill. 423; City of Williamsport *v.* Commonwealth, 84 Pa. St. 487; City of Lafayette *v.* Cox, 5 Ind. 38; Hardy *v.* Merriweather, 14 Ind. 203; Daily *v.* City of Columbus, 49 Ind. 169; Kyle *v.* Malin, 8 Ind. 34; Dill. on Mun. Corp. § 55, note 1, and §§ 81-85. As to the kind and form of evidences and obligations to be executed in such contracts by the authorities, see Sheffield School T'p *v.* Andress, 56 Ind. 157; School Town of Monticello *v.* Kendall, 72 Ind. 91; Bicknell *v.* Widner School T'p, 73 Ind. 501.

[1] Friend *v.* Gilbert, (1871) 108 Mass. 408, MORTON, J., said: "The power of towns to raise and appropriate money is derived wholly from statutes. The statutes do not attempt to enumerate all the purposes for which money may be raised, but after specifying some of the more prominent ones provide that towns may grant and vote such sums as may be required "for all other necessary charges arising therein." Gen. St. Mass. chap. 18, § 10. It is under this general provision that towns have the power to vote money for the erection of town houses. Stetson *v.* Kempton, 13 Mass. 272. The right to build carries with it by implication the power to make contracts, to waive or alter them and to make arrangements for the payment of those who furnish labor and materials."

[2] Dearborn *v.* Brookline, (1867) 97 Mass. 466. In Inhabitants of Westbrook *v.* Inhabitants of Deering, (1874) 63 Me. 231, the words "necessary charges" in the statute as to the powers of towns to incur expense received a full discussion from the court in these words: "The construction of this clause came before this court three years after the separation in Bussey *v.* Gilmore, 3 Me. 191, by which a tax for the discharge of a contract between a town and a toll bridge corporation for the free passage of the bridge by the citizens of the town was held illegal upon the ground that the power to raise money for 'necessary charges' extends only to those expenses which are incident to the discharge of corporate duties." WESTON, J., says: "The construction of the statutes in relation to the authority of towns to raise, assess and collect money is so clearly stated and so fully illustrated in Stetson *v.* Kempton, 13 Mass. 272, that we have little occasion to say more than that we are entirely satisfied with the principles of that case and the deductions there drawn. The court remark that 'it is important that it should be known that the power of the majority over the property and even the persons of the minority is limited by law to such cases as are clearly provided for and defined by the statute which describes the powers of these corporations.' By that decision this principle did become known; and believing that it is justified, as well from considerations of public policy as from a sound construction of the law, we have no disposition to modify or change it if we had the power to do so, which we clearly have not. * * * The generality of this phrase has received in the case above referred to a reasonable limitation. Without enumerating the objects which this term may be understood to embrace, it may in general be considered as extending to such expenses as are clearly incident to the execution of the power granted or which necessarily arise in the fulfilment of the duties imposed by law." The Maine Supreme Court of Judicature in 1863 in answer to questions submitted by the governor said: "The words 'other necessary town charges' do not constitute a new and distinct grant of indefinite and unlimited power to raise money for any purpose whatsoever, at the will and pleasure of the majority. They embrace only all incidental expenses arising directly or indirectly in the due and legitimate exercise of the various powers conferred by statute. While towns may raise money to discharge all liabilities in the performance of their multiplied duties, they cannot (unless new powers are conferred, or an excess of power receives a subsequent legal ratification) transcend their authority and incur expenses in no way arising in its exercise." Opinion of the Justices, 52 Me. 595, 598.

§ 16. Purchase of sites for, erection of, and the repairs of school buildings.— The school trustees of an incorporated town, under the general law of Indiana, having filed with the board of trustees of such town a verified report, showing that they have contracted for the purchase of real estate on which to erect school buildings, and showing the amount of the debt incurred for such realty, and other estimated cost of the buildings, and asking the issue of bonds, the board of trustees under the statute relating to such bodies may, by ordinance, authorize the issue and sale of the bonds of the town equal in amount to the cost of the real estate and the estimated cost of the projected school buildings, not

exceeding a limit specified in the statute.[1] The general power given a common council of a city by its charter to purchase land for the necessary purposes of the corporation, would be qualified by another provision that the board of education shall have power, with the consent of the common council, to buy sites for schoolhouses in such city, and a valid purchase of a site for a schoolhouse could be made only by the concurrent action of the two bodies.[2] And these two bodies cannot delegate the power of purchasing a schoolhouse site to a board of commissioners of such city without an express grant from the legislature of authority to do so.[3] A tax for the erection of a new schoolhouse may be voted by the electors of a school district before any site for the house has been selected.[4] And the electors of such a district have been held to have been warranted in voting a tax for the erection of a new schoolhouse at the center of the district in a case where the district, two miles wide from east to west, had one schoolhouse situated one-half mile east of the center, which was about thirty years old, but in reasonably good condition, yet too remote for some of the children of the district to attend school.[5] Under the constitutional limitation of Indiana upon municipal corporations, a town cannot issue bonds to obtain funds with which to rebuild a schoolhouse, should the issuance of the bonds create a debt in excess of two per centum of the taxable value of the property within the limits of the town.[6] Petitions from property owners are not necessary to authorize the board of trustees of incorporated towns in Indiana to issue bonds or procure money with which to build schoolhouses.[7]

§ 17. The same subject continued.—A statute conferring express authority upon a municipal corporation "to aid in the

[1] Williams *v.* Town of Albion, (1877) 58 Ind. 329.

[2] Lauenstein *v.* City of Fond du Lac, (1871) 28 Wis. 336.

[3] Ibid

[4] Seaman *v.* Baughman, (1891) 82 Iowa, 216; s. c., 47 N. W. Rep. 1091.

[5] Ibid.

[6] Town of Winamac *v.* Huddleston, (1882) 132 Ind. 217; s. c., 31 N. E. Rep. 561. The court said: "The debt created by a bond executed by a public corporation is not an obligation payable out of specific funds, but is a contract to pay money generally, and hence this case is not within the doctrine of such cases as Quill *v.* City of Indianapolis, 124 Ind. 292; s. c., 23 N. E. Rep. 788; Strieb *v.* Cox, 111 Ind. 299; s. c., 12 N. E. Rep. 481; and Board, etc., *v.* Hill, 115 Ind. 316; s. c., 16 N. E. Rep. 156.

[7] Clark *v.* Town of Noblesville, (1878) 44 Ind. 83.

building up of such schools and institutions of learning as they may think proper," clearly implies the power to build a house for that purpose.[1] Unless there is something in the charter of a municipal corporation, such as a city or town, which forbids it, such a corporation, without express authority, may incur liability for the building of a school house, it being clearly within the scope of the general power of such corporations.[2] The application of corporate funds, or creating a corporate debt, for the purchase of the interest in a building to be used as a public school or college for the accommodation of the people of a town is within the purposes and scope of the corporation.[3] And should it appear that the enterprise is not for any private gain, and that a board of trustees not elected by the municipal corporation contract to keep up in the building a public school, the fact that the superintendence of the school is left in the hands of such trustees would not render the appropriation of the corporate funds or the debt created illegal.[4] The charter of a board of public schools in Missouri gave the board power "to purchase, receive and hold property real and personal; to lease, sell or dispose of the same, *and do all other acts as natural persons*," and also "generally to do all lawful acts which may be proper and convenient to carry into effect the objects of the corporation." These provisions, taken in connection with the whole charter, have been construed not to authorize the board to create a debt for building a school house and to issue bonds to pay the debt.[5] Besides the provision in the charter of the board authorizing it to make an annual estimate of the amount of money to be raised for the purpose of building, repairing and furnishing school houses and requiring the County Court to cause the same to be levied and collected upon all taxable property in the school district was a limitation upon the power of the board regarding the building of school houses, and did not authorize the board to create a debt for that purpose and issue bonds for the payment of the debt.[6]

[1] Mayor, etc., of Cartersville *v.* Baker, (1884) 73 Ga. 686.

[2] Ibid; citing Frederick *v.* City Council of Augusta (1848) 5 Ga. 561; Danielly *v.* Cabaniss, (1874) 52 Ga. 211.

[3] Danielly *v.* Cabaniss, (1874) 52 Ga. 211.

[4] Ibid.

[5] Erwin *v.* St. Joseph Board of Public Schools, (1880) 2 McCrary, 608.

[6] Ibid; approving the reasoning in Gause *v.* Clarksville, 19 Alb. L. J. 253.

§ 18. Purchasing on credit.—The trustees of towns in Indiana being prohibited by statute from borrowing money or contracting a debt except upon the petition of five-eighths of the citizen taxpayers of the town, in the absence of such a petition cannot purchase cemetery grounds on credit.[1]

§ 19. Building and repair of bridges and roads.—Where the statute not only authorizes the supervisors of a township to repair the roads and build the bridges, but makes it their imperative duty to do so, and subjects them to fine and imprisonment for neglecting to keep the roads and bridges in a safe and passable condition, money is a necessary means to execute this power and perform this duty, and where it can only be obtained by borrowing it the power to do so is necessarily implied and passes as an incident to the execution of the general powers given and the performance of the duties required.[2] An incorporated town charged with the control of its streets and the duty to improve them may legitimately contract for the construction of free bridges over a stream dividing its streets, and by an issue of warrants or bonds raise the money necessary for the purpose.[3] But a municipal corporation cannot erect a toll bridge unless expressly authorized by law; nor has it power to lend its credit or make its accommodation paper for the benefit of citizens to enable them

[1] Pratt *v.* Luther, (1873) 45 Ind. 250. See Ketchum *v.* City of Buffalo, 14 N. Y. 356, holding that if the charter of the city or the general law of the state did not forbid the purchase of ground for a market place to be made on credit the city could purchase such grounds on credit. The court said: "A municipal corporation, therefore, may at common law, unless restrained by some statute, purchase and hold all such real estate as may be necessary to the proper exercise of any power specifically conferred," etc. And afterwards: "I think it must be conceded that the city had power to purchase ground for a public market. If so there is nothing in the charter or general law of the state forbidding the purchase to be made on credit."

[2] Maneval *v.* Jackson Township, (1889) 9 Pa. Co. Ct. Rep. 28. The court distinguished Union Township *v.* Gibboney, 94 Pa. St. 534, and Gibson *v.* Poor District, 122 Pa. St. 557. In Mills *v.* Gleason, 11 Wis. 470, the Wisconsin Supreme Court held that "where the charter of a municipal corporation confers the power to purchase fire apparatus, cemetery grounds, to establish markets and to do many other things for the execution of which money would be a necessary means, it also, in the absence of any positive restriction, confers the power to borrow money as an incident to the execution of these general powers."

[3] Mullarky *v.* Town of Cedar Falls, (1865) 19 Iowa, 21.

to execute private enterprises.[1] Authority being given by a charter of a city to its common council "to appropriate in any one year, over and above the ordinary expenses needed on the bridges in said city, an expenditure not to exceed ten thousand dollars, for the building of a new bridge in said city, or for any extraordinary repairs on any bridge, and for the payment of the same in whole or in part," and the charter declaring further that "the council, instead of collecting the same in the next tax roll, may issue its bonds," etc., these provisions would not prevent the council letting by a single contract the work of constructing a bridge at a greater price than $10,000. The provisions merely limit the amount to be raised by taxation, or the amount of the bonds to be issued, in any one year to pay for such work.[2] A statute authorizing two of the counties of Alabama to erect a bridge, which might be either a free foot and wagon bridge for the traveling public, or a railroad bridge, or both combined, has been held to contravene the constitutional provision which denies to the legislature power to authorize any county to lend its credit or to grant public money or a thing of value in aid of or to any individual, association or corporation.[3] The governing authorities of a county, having, under authority from the legislature, purchased certain bridges from private parties, and changed them from toll to free bridges, upon their being destroyed by freshets, or otherwise, may rebuild them.[4]

§ 20. Incurring liability under California statutes.— The power to levy and collect a tax in the charter of a city "for any object whatever within the provision of the corporate powers before given," will not authorize the levy and collection of a tax for making a survey of a railroad route from the city to another.[5] The power granted to a city to take stock "in any public improvement, or effect a loan for any purpose," upon obtaining the con-

[1] Clark *v.* City of Des Moines, (1865) 19 Iowa, 199.

[2] Howard *v.* City of Oshkosh, (1873) 33 Wis. 309.

[3] Garland *v.* Board of Revenue, 87 Ala. 223; s. c., 6 So. Rep. 402.

[4] Elliott *v.* Gammon, (1886) 76 Ga. 766. See Washer *v.* Bullitt County, (1884) 110 U. S. 558, involving the question of the power of a county in Kentucky to build a bridge at its own cost across a boundary creek, one end of the bridge extending into the territory of another county, in which the Supreme Court of the United States construed the Kentucky statutes relating thereto.

[5] Douglass *v.* Mayor and Common Council of Placerville, (1861) 18 Cal. 643.

sent of the people at an election held for the purpose cannot be extended to improvements other than municipal in their character. Under such a power, for instance, a city cannot subscribe to stock in a navigation company.[1]

§ 21. Incurring liability under Indiana statutes.— The board of commissioners of a county in Indiana, under their power "to make all orders respecting the property of the county * * * and to take care of and preserve such property," may contract for insurance upon the public buildings of the county.[2] While at the time of the passing of an order by an Indiana board of county commissioners, making a donation for the purpose of securing the location of an agricultural college within their jurisdiction and making an appropriation to pay the same, the Supreme Court of that state held that the order was not void, but was capable of ratification by the legislature. And this order was ratified and rendered valid by subsequent legislation accepting the donation and locating the college in that county. And the law authorizing a collection by taxes of the amount donated for this purpose was not objectionable as being local or special when a general law could have been made applicable.[3] There is no power in an Indiana board of county commissioners to furnish aid to a gravel road or turnpike company in building or repairing its road at the expense of the county, neither can they enter into a contract with such companies for the future repairs of a bridge or the approaches to such bridge on the line of its road.[4] Such a board cannot make a contract

[1] Low *v.* Mayor and Common Council of Marysville, (1855) 5 Cal. 214. The court said: "The words 'public improvements' when applied to a municipal government must be taken in a limited sense as applying to those improvements which are the proper subject of police and municipal regulation — such as gas, water, almshouses, hospitals, etc. — and cannot be extended to subjects foreign to the object of the incorporation and beyond its territorial limits. Without referring to the many privileges exercised by the free cities of Europe, some of which exercised almost all the power of sovereignty by virtue of royal patent or their own usurpation, we understand the powers of municipal corporations to be limited, particularly in the United States, to the express grant of their charters, the object of their creation to be governmental and not commercial."

[2] Potts *v.* Bennett, (Ind. 1895) 39 N. E. Rep. 518.

[3] Marks, Treasurer of Tippecanoe County *v.* Trustees of Purdue University, (1871) 37 Ind. 155; see Cash *v.* Auditor of Clark County, 7 Ind. 227; Stocking *v.* The State, 7 Ind. 326.

[4] Driftwood Valley Turnpike Co. *v.* Board of Comrs. of Bartholomew County, (1880) 72 Ind. 226.

conditionally to pay certain expenses of boring wells for oil and digging for minerals.[1] Neither can it appropriate the funds of the county to the payment of the debts of a county agricultural joint-stock company or to the building of schoolhouses.[2] It is not, under the Indiana laws regulating the incorporation of cities, etc., within the power of a city council to contract to pay its marshal any sum of money for the performance of any duties outside of his official duties.[3]

§ 22. Incurring liabilities under Kansas statutes.— The grant of power by the Kansas statutes to townships to issue bonds "to aid in the construction of railroads or water power by donation thereto, or the taking stock therein or for other works of internal improvement" includes authority to assist in the construction of depots and sidewalks of a railroad.[4] A statute authorizing a municipal corporation to issue bonds which can only be paid by taxation, for the benefit of a manufacturing enterprise of private persons has been held to be void as violating the fundamental rights of property, the purpose being essentially private in its nature, though the public may be incidentally benefited.[5] In the same federal court municipal bonds issued under legislative authority to be paid by taxation as a bonus or donation to secure the location, or aid in the erection of a manufactory or foundry owned by private individuals were held to be void even in the hands of holders for value.[6] County commissioners in Kansas may employ counsel to take charge of litigation on behalf of the county where the county is interested in the result of the action, either in its own behalf, or in that of some township of the county, where the suit is brought against the representatives of the county, and is beyond the limits of the county.[7] Though made their duty, unless the charter of municipal corporations expressly permits it, they cannot levy a tax for the erection of schoolhouses.[8] A trustee of a town in Kansas

[1] Burnett *v.* Abbott, 51 Ind. 254.

[2] Warren County Agricultural Joint Stock Co. *v.* Barr, 55 Ind. 30; Rothrock *v.* Carr, 55 Ind. 334.

[3] City of Brazil *v.* McBride, (1879) 69 Ind. 244.

[4] Township of Rock Creek *v.* Strong, (1877) 96 U. S. 271.

[5] Citizens' Savings Association *v.* Topeka, (1874) 3 Dill. 376.

[6] Commercial National Bank *v.* Iola, (1873) 2 Dill. 353.

[7] Thacher *v.* Jefferson County, 13 Kans. 182.

[8] Leavenworth *v.* Norton, 1 Kans. 432.

has no power to bind the county by a contract with a physician for treatment of persons sick with smallpox. The power to do so is alone in the commissioners of the county.[1] Neither is a county in Kansas bound to pay a physician for medical services rendered by him in attending on prisoners confined in the county jail, except when authorized by the county commissioners.[2]

§ 23. For lighting the streets of a city.— The contention in an Indiana case was that to regulate the lighting of the streets of a city is a legislative power which cannot be delegated away, surrendered or restricted by contracts or otherwise, and that, therefore, the contract made by the city authorities with a gas company for lighting its streets for a term of years was a restriction upon that legislative power, and, therefore, invalid. The Supreme Court of the state held the contract binding upon the city, and enforceable in the same manner as the contract of a person or a business corporation; also, that it could not be repealed, impaired or changed by the city by ordinance or otherwise.[3]

[1] Smith *v.* Shawnee County, 21 Kans. 669.

[2] Roberts *v.* Pottawatomie County, 10 Kans. 29.

[3] City of Indianapolis *v.* Indianapolis Gas Light & Coke Co., (1879) 66 Ind. 396. As to the power to contract, it was said by BIDDLE, J., speaking for the court: "No corporation can construct unless the power is granted by law. This power is generally granted to business corporations, as for banking, manufacturing, shipping; and such corporations generally have no legislative or governmental powers, except the power to make by-laws for their own government; they cannot pass ordinances for the government of others. Municipal corporations, besides the power to contract, which is generally granted to them within certain limits, have legislative or governmental powers by which they make by-laws to govern themselves and pass ordinances to govern others, or the citizens of a town or city within their geographical limits. This power to legislate within the authority delegated to them by law is distinct from the power to contract, although exercised by the same corporation. They cannot, by contract, delegate or restrict their legislative power, nor can they, merely by their legislative power, make a contract. These two powers need not be confounded. The exercise of the legislative power requires the consent of no person except those who legislate, while it is impossible to make a contract without the consent of another, or others. We think, therefore, that when [this city] made the contract in question with the gas light company it made it in the exercise of its power to contract, and not in the exercise of its power to legislate, although the power to make the contract was authorized by an ordinance; and having the power to make a contract touching the subject-matter, it had the right to make it according to its own discretion as to its prudence or good policy within the limits of its franchise." The court commented upon Roll *v.* City of Indianapolis, 52 Ind. 547, and distinguished Rittenhouse *v.* Mayor & City Council of Baltimore, 25 Md. 336; Gale *v.* Village of Kalamazoo, 23 Mich. 344, and City of Oakland *v.* Carpentier, 13 Cal. 540. They considered their views to be sustained by the main consent of the following authorities: Evansville, Ind. & Cleveland Straight Line R. R. Co. *v.* City of Evansville, 15 Ind. 395; Nelson *v* City of La Porte, 33 Ind. 258; City of Indianapolis *v.* Bly, 39 Ind. 373; City of Crawfordsville *v.* Hays, 42 Ind. 200; State Board of Agriculture *v.* Citizens' St. Ry. Co., 47 Ind. 407; Board of Comrs. of Tippecanoe County *v.* Everett, 51 Ind. 543; San Francisco Gas Co. *v.* City of San Francisco, 9 Cal. 453; Roll *v.* City of Indianapolis, 52 Ind 547; Davenport *v.* Inhabitants of Hallowell, 10 Me. 317; Bailey *v.* Mayor, etc., City of New York, 3 Hill, 531; Masterton *v.* Mayor, etc., City of Brooklyn, 7 Hill, 61; Milhau *v.* Sharp, 27 N. Y. 611; Richmond County Gas Light Co. *v.* Town of Middletown, 59 N. Y. 228; Devlin *v.* Mayor, etc., City of New York, 63 N. Y. 8; Mayor & Council of Rome *v.* Cabot, 28 Ga. 50; Intendant & Town Council of Livingston *v.* Pippin, 31 Ala. 542; State of New York *v.* Mayor, etc., City of New York, 3 Duer, 119; Britton *v.* Mayor, etc., New York, 21 How. Pr. 251; Louisville City Ry. Co. *v.* City of Louisville, 8 Bush, 415; Harlem Gas Light Co. *v.* Mayor, etc., New York, 33 N. Y. 309; Illinois & St. Louis R. R. & Canal Co. *v.* City of St. Louis & Pacific Elevator Co., 2 Dill. 70; State of Ohio *v.* Cincinnati Gas Light & Coke Co., 18 Ohio St. 262; Gall *v.* City of Cincinnati, 18 Ohio St. 563; Minturn *v.* Larue, 23 How. 435; Memphis City *v.* Dean, 8 Wall. 64; Chicago *v.* Sheldon, 9 Wall. 50; Hitchcock *v.* Galveston, 96 U. S. 341; Edwards *v.* Kearzey, 96 U. S. 595; People *v.* Common Council of Detroit, 28 Mich. 228; Mayor, etc., of Jackson *v.* Bowman, 39 Miss. 671; Davenport Gas Light & Coke Co. *v.* City of Davenport, 13 Iowa, 229; State of Wisconsin *v.* Milwaukee Gas Light Co., 29 Wis. 454; Norwich Gas Light Co. *v.* Norwich City Gas Co., 25 Conn. 19; Western Saving-Fund Society of Philadelphia *v.* City of Philadelphia, 31 Pa. St. 175; Philadelphia *v.* Fox, 64 Pa. St. 169.

§ 24. Contract on time for lighting streets.— A municipal corporation may contract on time with a gas or other lighting company for a supply of gas or light for several years, as it would not be the contracting of a debt within the scope of section 2448 of the Revised Statutes of Louisiana, which provides that the "police juries of the several parishes and other constituted authorities of incorporated towns and cities in this state shall not hereafter have power to contract any debt or pecuniary liability without fully providing in the ordinance creating the debt the means of paying the principal and interest of the debt as contracted."[1] The

[1] New Orleans Gas Light Co. *v.* City of New Orleans, (1890) 42 La. Ann. 188; s. c., 7 So. Rep. 559. The court said: "There is no stipulation or expression, either in the contract or ordinance, on which to ground the contention that the city thereby intended to contract a debt. The agreement imparts no absolute and binding obligations on the part of the city to pay any sum of money for a consideration pre-existing or executed on the part of the obligee which is of the essence of a

court held further that in the absence of a special statutory limitation or restriction the power given to the city to make contracts for lighting its streets, landings, etc., was sufficient to authorize a contract for more than one year for such commodity.[1]

§ 25. Caring for the indigent, etc.— There is inherent in every municipal corporation the power to relieve sick persons indigent in their circumstances, especially in times of epidemic diseases, and to provide for poor persons who are unable to labor.[2] A city with power delegated to it to provide for foundlings, the insane, the indigent, infirm and helpless, and for the correction of the vicious and vagrant portions of its population, if it has not provided for such persons, or if they can be better cared for and trained in other institutions than in those of the city, may contract for such care and training by such other institutions. But the exercise of the power of making such contracts must be with the limitation that the subject-matter of the contract be kept within the power and control of municipal authority, and that complete accountability be provided for, and thus make the institution contracted with, *pro hac vice*, municipal officers.[3]

debt. The obligation of the city for future disbursements in favor of the company is conditioned on the performance on the part of the latter of its part of the contract, a fact to be ascertained under the terms of the contract itself from month to month. Although the eventual disbursements to be made by the city may amount to several hundred thousand dollars, it is certainly not correct to argue that the effect of the contract was to place it in debt to that amount. If under the terms of the contract the company furnishes and operates in quality and quantity the lights contemplated and agreed upon, and if payments are made therefor by the city from month to month, as stipulated in the contract, the city would certainly never be in debt to the company. Hence we conclude that no indebtedness was contemplated to flow from or was created by the contract." On authority of Weston *v.* Syracuse, 17 N. Y. 110; City of Valparaiso *v.* Gardner, 97 Ind. 1; s. c., 7 Am. & Eng. Corp. Cas. 626.

[1] New Orleans Gas Light Co. *v.* City of New Orleans, (1890) 42 La. Ann. 188; s. c., 7 So. Rep. 559; citing in support of the ruling City of Indianapolis *v.* Indianapolis Gas Light Co., 66 Ind. 396; Weston *v.* Syracuse, 17 N. Y. 110; City of Valparaiso *v.* Gardner, 97 Ind. 1; Atlantic Water Works *v.* Atlantic City, 15 Am. & Eng. Corp. Cas. 327.

[2] Vionet *v.* Municipality No. 1, 4 La. Ann. 42.

[3] St. Mary's Industrial School for Boys *v.* Brown, (1876) 45 Md. 310. It was said by the court: "The authority (to provide for such persons) that is held and exercised in this behalf is a trust, as well for those who become the objects of it, as those who support it by contribution in the form of taxes levied upon their property, and being an important public trust it cannot be delegated beyond the power and discretion of those to whom it is confided."

§ 26. Employment of physicians for the poor — Indiana statute construed.— The Indiana statute[1] makes it the duty of the board of commissioners of a county "to contract with one or more skillful physicians, having knowledge of surgery, to attend upon all persons confined in jail, or paupers in the county asylum, and may also contract with physicians to attend upon the poor generally in the county. * * * Provided that this section shall not be so construed as to prevent the overseers of the poor, or any one of them, in townships not otherwise provided for, from employing such medical or surgical services as paupers within his or their jurisdiction may require." The Supreme Court has held that a county is not liable to a physician for medical services rendered by him to a poor person, when the physicians employed by the board of county commissioners to attend the poor, as required by this statute, refused to act, and when the town trustee, who by statute is the overseer of the poor, declined to employ this physician.[2]

§ 27. Expenses connected with epidemic diseases.— The Supreme Court of Alabama has held that a contract by a city

[1] Ind. Rev. St. (1881) § 5764.

[2] Morgan County *v.* Seaton, (1889) 122 Ind. 521; s. c., 24 N. E. Rep. 213. The holding of the court has been uniform that the overseer of the poor, under this statute, has power to employ a physician only in the event the board of commissioners fail to make suitable provision for attendance upon the poor by contract. Board, etc., *v.* Boynton, 30 Ind. 359; Board, etc., *v.* Hon, 87 Ind. 356. But the overseer of the poor, in case the physician employed by the board is not accessible, and an emergency is deemed to exist, or if he refuses for any reason to act, may employ a physician in case of urgent necessity to treat one in need of medical aid, and, in the absence of fraud, the county will be bound by his judgment and liable for the medical services, notwithstanding the employment of a regular physician by the county. Board, etc., *v.* Seaton, 90 Ind. 158; Washburn *v.* Board, etc., 104 Ind. 321; s. c., 3 N. E. Rep. 757; see, also, Comrs., etc., *v.* Holman, 34 Ind. 256. As to the powers of town trustees under this statute, see Robbins *v.* Board of Comrs. of Morgan County, (1883) 91 Ind. 537. As to the terms, etc., of a contract with a physician under this statute, see Board of Comrs., etc., *v.* Ritter, (1883) 90 Ind. 362. As to the duty and power of a town trustee under Ind. Rev. St. (1881) § 6089, in providing for persons in need of temporary relief, see Board of Comrs., etc., *v.* Jennings, (1885) 104 Ind. 108; s. c., 3 N. E. Rep. 619. The mere fact that a board of commissioners employs physicians to attend the poor of a county will not operate as a limitation upon the power of a township trustee as overseer of the poor to employ others in case of emergency. Board of Comrs. of Perry County *v.* Lomax, (1892) 5 Ind. App. 567; s. c., 32 N. E. Rep. 800.

with a physician, entered into during the late war, to attend to indigent persons sick with the smallpox, whether belligerents or non-belligerents, was not such a contract as is forbidden by the law of the land or public policy.[1] A statute authorizing the board of supervisors of a city "to allow and order paid out of the general fund, not to exceed six thousand dollars for any one year, for the support of" a smallpox hospital, has been held in California not to authorize the board to purchase a site for a smallpox hospital.[2] Neither was the purchase of a site for the hospital authorized by the statute giving the board power to make all regulations which may be necessary or expedient for the prevention of contagious diseases, nor by the constitutional provision of the state authorizing a city to make all such police, sanitary and other regulations as are not in conflict with general laws.[3]

§ 28. For what towns may not be made liable.—A town has no authority to appropriate money for the payment of expenses incurred by individuals, prior to its corporate existence

[1] City of Selma *v.* Mullen, (1871) 46 Ala. 411; in this case, where it appeared that the usage of the city authorities was to have the city physician attend to smallpox cases for an extra compensation, and the city physician, plaintiff here, had been told by one of the aldermen in the presence of the others, no one objecting, to "go on, doctor, with your smallpox cases, and we will do what is just and right," it was held that the city was bound by an implied promise to pay him a reasonable value for his services in this respect. As to an action of assumpsit lying against corporations upon an express or implied promise, see Bank of Columbia *v.* Patterson, 7 Cranch, 299; Bank of U. S. *v.* Dandridge, 12 Wheat. 64; Danforth *v.* Schoharie & Duanesburgh Turnpike Road, 12 Johns. 227; Montgomery County *v.* Barber, 45 Ala. 237.

[2] Von Schmidt *v.* Widber, City Treasurer, (1894) 105 Cal. 151; s. c., 38 Pac. Rep. 683. The court said: "(Authority to make such a purchase) cannot be implied from the power conferred upon the board of supervisors by the statute. Aside from the fact that this statute makes no mention of real estate, or of any purchase thereof, its language limits the power to the expenditure of 'six thousand dollars for any one year,' and the money thus allowed to be expended is for the 'support' of the smallpox hospital — words which eminently refer to an existing hospital, rather than to one to be thereafter brought into existence. It is not to be inferred that when the legislature was thus careful in limiting the amount of money to be expended, and in the language in which it described the mode of its expenditure, it intended to confer an unlimited authority upon the board of supervisors to expend any amount of money that it might choose for the purchase of a site for the hospital for whose support it had thus provided."

[3] Von Schmidt *v.* Widber, City Treasurer, (1894) 105 Cal. 151; s. c., 38 Pac. Rep. 683 citing as authority for the last proposition, Ketchum *v.* City of Buffalo, 14 N. Y. 356.

as a town, in procuring the passage of its charter.[1] In the commonwealth of Massachusetts towns have no authority to expend money or pledge their credit to celebrate the anniversary of the surrender of Cornwallis.[2] Nor has it authority to appropriate money for the celebration of the Fourth of July.[3] By the statute of 1861 (Chap. 165) cities are now authorized in Massachusetts to appropriate money to celebrate a holiday, but such authority can be exercised only in pursuance of a "vote of two-thirds of the members of each branch of the city council present and voting by yea and nay vote.[4]

[1] Frost *v.* Belmont, (1863) 6 Allen, 152.

[2] Tash *v.* Adams, Treasurer, (1852) 10 Cush. 252.

[3] Hood *v.* Lynn, (1861) 1 Allen, 103. BIGELOW, Ch. J., said, after referring to the power of towns to raise money for "all other necessary charges": The appropriation is neither necessary to the exercise of any power expressly granted to the city; nor is it incidental to any right or authority, which, though not expressly granted, has its origin in well-settled usage and is founded upon the necessities, convenience, or even the comfort of the inhabitants. This is the extreme limit of the power of towns and cities to grant money as settled by repeated adjudications of this court. Stetson *v.* Kempton, 13 Mass. 272; Parsons *v.* Goshen, 11 Pick. 396; Willard *v.* Newburyport, 12 Pick. 227; Allen *v.* Taunton, 19 Pick. 485; Spaulding *v.* Lowell, 23 Pick. 71; Anthony *v.* Adams, 1 Metc. 284. See, also, Gerry *v.* Stoneham, (1861) 1 Allen, 319. In New London *v.* Brainard, 22 Conn. 553, an appropriation which had been voted by the city for the celebration of Independence Day was held to have been properly enjoined as beyond the power of the city under its charter and the laws generally. As to the power of a city under the power given in its charter to raise and expend moneys "to defray the contingent and other expenses of the city" to provide an entertainment for its citizens at the expense of the city, see Hodges *v.* Buffalo, 2 Den. 110; New London *v.* Brainard, 22 Conn. 553.

[4] Morrison, Admx., *v.* Lawrence, (1867) 98 Mass. 219. In Morton *v.* City of Nevada, 41 Fed. Rep. 582, bonds issued by the city for the purchase of a right of way and depot grounds for a railroad were held to be void as violating the constitutional provision of Missouri declaring that the general assembly shall not authorize any city to loan its credit to any corporation unless two thirds of the qualified voters assented thereto. It was further held that the purchaser of these bonds could not maintain an action against the city for money paid and received to recover the amount paid the city for the bonds, as the city having no power to create the debt, no implied promise could arise for its payment, notwithstanding the general statute of Missouri, which gives the board of trustees power "to borrow money for the improvement" of the town, the purchase of highway and depot grounds for the railroad not being for the improvement of the town, but a debt incurred for the benefit of the railroad corporation without the proper assent of voters.

§ 29. Expenses of a committee to secure legislation.— A town cannot raise by taxation or by pledge of its credit, or pay from its treasury, money for the expenses of a committee directed by a vote of the town to petition the legislature for the annexation of the town to another town.[1] Neither can it raise

[1] Minot *v.* West Roxbury, (1873) 112 Mass. 1. ENDICOTT, J., as to proper construction of the words "necessary charges," referred to the various Massachusetts cases previous to this one as follows: "The leading case is Stetson *v.* Kempton, 13 Mass. 272. The meaning of the word 'necessary' in the statute is discussed at length by Chief Justice PARKER, with a fulness of illustration in regard to the various expenses which may be said to fall within the words 'necessary charges,' that seem to exhaust the subject, and has not been materially enlarged by later decisions. He says: 'The phrase 'necessary charges' is indeed general; that the very generality of the expression shows that it must have a reasonable limitation. For none will suppose that under this form of expression every tax would be legal which the town should choose to sanction. The proper construction of the term must be that in addition to the money to be raised for the poor, schools, etc., towns might raise such sums as should be necessary to meet the ordinary expenses of the year, such as the payment of such municipal officers as they should be obliged to employ, the support and defense of such actions as they might be parties to, and the expenses they would incur in performing such duties as the laws imposed, as the erection of powder houses, providing ammunition, making and repairing highways and town roads, and other things of a like nature, which are necessary charges because the effect of a legal discharge of their corporate duty. The erection of public buildings for the accommodation of the inhabitants, such as town houses to assemble in and market houses for the sale of provisions, may also be a proper town charge, and may come within the fair meaning of the term *necessary*, for these may be essential to the comfort and convenience of the citizens. * * * With respect to the defense of any town against the incursions of an enemy in time of war, it is difficult to see any principle upon which that can become a necessary town charge. It is is not a corporate duty,' etc. In another case * * * Rumford School District *v.* Wood, 13 Mass. 193, the chief justice said of towns that they may be considered as *quasi* corporations, with limited powers co-extensive with the duties imposed on them by statute or usages. The rule of construction laid down in these early cases has been strictly followed in the later decisions. In Parsons *v.* Goshen, 11 Pick. 396, Mr. Justice WILDE says: 'The important question in this case is settled, and upon principles that cannot be controverted, in Stetson *v.* Kempton.' In Anthony *v.* Adams, 1 Metc. 284, Chief Justice SHAW said: 'It is now well settled that a town, in its corporate capacity, will not be bound, even by an express vote of a majority, to the performance of contracts or other legal duties not coming within the scope of the objects and purposes for which they are incorporated.' In Vincent *v.* Nantucket, 12 Cush. 103, it was said by Mr. Justice MERRICK: 'Their contracts will be valid when made in relation to objects concerning which they have a duty to perform, an interest to protect, or a right to defend. But here is the extent at once of their right and their power. They cannot engage in enterprises foreign to the purposes for which they were incorporated, nor assume responsibilities which involve undertakings not within the compass of their corporate powers.' Following this rule of construction, this court has held expenditures to be legal though not within the express terms of the statute, but incidental to and within the scope of a power of a town, as for the erection of market and town houses, and the construction of reservoirs to supply fire engines. Spaulding *v.* Lowell, 23 Pick. 71; French *v.* Quincy, 3 Allen, 9; Hardy *v.* Waltham, 3 Met. 163. For the support of a public clock, as within the jurisdiction of a town, in the same manner as hay scales, burying grounds, wells and reservoirs, being objects of convenience and necessity to the inhabitants. Willard *v.* Newburyport, 12 Pick. 227. A town may also indemnify its officers against liabilities incurred in the *bona fide* discharge of their official duties, as in regard to the reassessment of taxes, the repairs of a highway, the report of a school committee, the erection of a town house, all incidental to and connected with the exercise of the powers of a town (Nelson *v.* Milford, 7 Pick. 18; Bancroft *v.* Lynnfield, 18 Pick. 566; Fuller *v.* Groton, 11 Gray, 340; Hadsell *v.* Hancock, 3 Gray, 526; Babbitt *v.* Savoy, 3 Cush. 530), and may pay for professional services in the defense of suits, independent of the result of the suit, and whether the town acted legally or illegally in the matter in controversy, it being in the ordinary administration of town affairs. Cushing v. Stoughton, 6 Cush. 389."

by taxation, or pay from its treasury, money for expenses incurred in opposing before the legislature the annexation of the whole or a part of its territory to another town.[1] A Maine town cannot incur expenses in opposing before a legislative committee a division of its territorial limits.[2]

§ 30. For the payment of bounties to volunteers.— The Illinois Supreme Court sustained the constitutionality of a law authorizing the towns in certain counties therein named to levy a tax to pay bounties to persons who should thereafter enlist or be drafted in the army of the United States, a vote of the township being first taken. The courts defined a tax for "corporate purposes" to mean "a tax to be expended in a manner which shall promote the general prosperity and welfare of the municipality which levies it," and held that a tax levied by the town for the purpose of paying bounties to such as would volunteer in the army during the late war in order thereby to exempt the town from an impending draft on conscription might be fairly considered a tax for the common good and for a "corporate purpose."[3]

[1] Coolidge *v.* Brookline, (1874) 114 Mass. 592.

[2] Inhabitants of Westbrook *v.* Inhabitants of Deering, (1874) 63 Me. 231.

[3] Taylor *v.* Thompson, (1866) 42 Ill. 9.

§ 31. Validating a contract of village trustees.— Under the statutes of New York there is required a submission of a proposition for furnishing a water supply to a vote of the electors before a contract can be made by the village trustees, if the cost is to exceed a certain sum. In case village trustees enter into a contract for this purpose, not authorized by this statute, and there is an attempt to ratify it by the electors of the village, the contract would not be validated as of the time when it was made, but simply rendered operative from and after the date of the vote.[1] And the statute as to submission to a vote of the electors of the matter in question was not modified by the subsequent statute providing for the submission "to the taxpaying electors," at a special election of the question of raising moneys for some proper village object additional to the amount already authorized, and for raising the same in like manner with other taxes, and authorizing the trustees to borrow such sum in emergency in anticipation of the tax, but granting them no authority to bond the village otherwise by contract.[2]

§ 32. Illustrations of liabilities incurred for a "corporate purpose."—The Illinois Supreme Court has held that where a tax was voted by a city to donate a sum of money in aid of normal school in case it should be located therein, and it was so located, and the

[1] Squire *v.* Preston, (1894) 82 Hun, 88; s. c., 31 N. Y. Supp. 174. The statute referred to is N. Y. Laws 1873, chap. 737, § 5, as amended by N. Y. Laws 1885, chap. 422.

[2] Squire *v.* Preston, (1894) 82 Hun, 88; s. c., 31 N. Y. Supp. 174. The later statute referred to is N. Y. Laws 1887, chap. 504; see, also, N. Y. Laws 1890, chap 566, § 81, which re-enacts in substance the act of 1873. See In re Commissioners of Central Park, 50 N. Y. 493; In re Evergreens, 47 N. Y. 216. The questions involved in Squire *v.* Preston, *supra*, were considered also in Squire *v.* Cartwright, (1893) 67 Hun, 218; s. c., 22 N. Y. Supp. 899, the contract made by the village trustees with the water company being for the erection and supply of hydrants. As to the points involved, the court cited: Smith *v.* Cramer, 14 N. Y. Wkly. Dig. 107; Hassan *v.* City of Rochester, 67 N. Y. 528. As to ratification of the contracts by a vote the court considered applicable the language of Judge DENIO in Peterson *v.* Mayor, etc., 17 N. Y. 449, 454, which was as follows: "No sort of ratification can make good an act without the scope of the corporate authority So where the charter, or a statute, binding upon the corporation, has committed a class of acts to particular officers or agents other than the general governing body, or where it has prescribed certain formalities as conditions to the performance of any description of corporate business, the proper functionaries must act, and the designated forms must be observed, and generally no act of recognition can supply a defect in these respects."

bonds of the city were regularly issued and put in circulation to that amount, such debt was incurred for a "corporate purpose," within the meaning of the constitutional provision allowing taxation for "corporate purposes."[1] So, also, held as to a certain issue of the city's bonds under legislative authority and upon a vote of its legal voters, whereby the city was relieved from the payment of a larger amount of its prior indebtedness.[2] The city being also authorized by the statute to give bonds to aid in the establishment and foundation of a university, and for that purpose having purchased grounds and submitted to vote of the people the question of issuing a certain amount of bonds to make payment for the lands, and it being carried, these bonds were also held to be for a "corporate purpose," there appearing no fraud, combination or oppression in the transaction.[3] The constitutional provision of New York prohibiting cities from incurring indebtedness except for city purposes, does not deprive the city of the power to construct and operate a plant for a supply of electric light to the city and its inhabitants, as this is a corporate purpose within the meaning of the constitutional provision.[4] Should a municipal corporation issue negotiable certificates of indebtedness, for instance, to a contractor for the performance of work to be done, or done, for an authorized corporate purpose, without legal authority or power to issue such certificates, the payee may maintain an action for money had and received; and the fact that the payee was not a party to the contract would be immaterial if the certificates are issued to him at the request of the contractor and the money received by the city and paid over to the contractor.[5]

§ 33. Purchase of fire engines and apparatus.— A town possesses inherent power to purchase fire engines for the protection of the property of its citizens from fire.[6] The statute of

[1] Burr *v.* City of Carbondale, (1874) 76 Ill. 455.

[2] Ibid.

[3] Ibid. In support of these views the court cited Merrick *v.* Inhabitants of Amherst, 12 Allen, 500.

[4] Hequembourg *v.* City of Dunkirk, 49 Hun, 550; s. c., 2 N. Y. Supp. 447.

[5] Bangor Savings Bank *v.* City of Stillwater, (1892) 49 Fed. Rep. 721; Louisiana *v.* New Orleans, 102 U. S. 204; Chapman *v.* Douglas County, 107 U. S. 348; s. c., 2 Sup. Ct. Rep. 62; Hitchcock *v.* Galveston, 96 U. S. 341.

[6] Corporation of Bluffton *v.* Studabaker, (1885) 106 Ind. 129. The court said: "The power to purchase fire engines by an incorporated city or town does not, however, of necessity, depend upon the question whether the charter of such city or town has,

Indiana for incorporating towns gives them power in one section among other things "to provide all necessary apparatus for the extinguishment of fires." Under this section a town is authorized to purchase a fire engine for cash.[1] Another section gives towns power "to incur a debt, on proper petition from the taxpayers of the town severally. * * *" Under this section the town may incur a debt for the purchase of a fire engine and apparatus, or purchase it upon credit.[2] Another provision of this law requires the assent of five-eighths of the taxpaying citizens of the town before there is power in the town to borrow money or incur any debt or liability. Upon a proper petition the board of trustees in this case passed an ordinance for raising the money necessary to pay for an engine by sale of the bonds of the town. The court held that the board had the power to disregard this ordinance for an issue and sale of bonds. Their power to purchase an engine on a credit was not exhausted by the mere passage of the ordinance for the issue and sale of bonds. The engine might be purchased by parol and

or has not, expressly granted such power. In 1 Dill. on Mun. Corp. (3d ed.) § 143, the learned author says: "The prevention of damage by fire is usually an object within the scope of municipal authority, either by express grant or by the power, in a chartered town or city, to make police regulations or needful by-laws, and for this purpose it may regulate the mode and removal of ashes. And where the town or municipal body has such power, it is authorized to appropriate money for the purchase of engines, or for the repair thereof, if to be used for the purpose of extinguishing fires therein, and this, whether they belong to the corporation or were purchased by private subscription." So in Clark *v.* City of South Bend, 85 Ind. 276; s. c., 44 Am. Rep. 13, the court said: "A municipal corporation has such powers as are expressly granted and also such implied or incidental ones as are necessary to carry into effect the express powers and effectuate the object of the corporate existence. It was long ago declared that the power to prevent danger from fire is an incidental one, belonging to all municipal corporations." So, also, in Baumgartner *v.* Hasty, 100 Ind. 575; s. c., 50 Am. Rep. 830, the court said: "The rule has always been that a municipal corporation has the inherent power to enact ordinances for the protection of the property of its citizens against fire. * * * The exercise of such a power is not the exercise of a new power, nor of one not connected with the purposes for which public corporations are organized; on the contrary, it is the exercise of a power long possessed by municipal corporations and closely connected with the purposes for which such corporations are organized."

[1] Second National Bank of New Albany *v.* Town of Danville, (1878) 60 Ind. 504.

[2] Second National Bank of New Albany *v.* Town of Danville, (1878) 60 Ind. 504.

in this case on credit, and notes commercial or otherwise might be executed for the price by the board of trustees of the town.[1] The power to purchase fire engines and apparatus is necessarily or fairly to be implied as incident to a power granted a city's common council to pass ordinances for the prevention and suppression of fires and to appoint and remove fire wardens; and, by ordinance to prescribe the powers and duties of such fire wardens and of the fire engineers and firemen; and also the right to raise money by taxation for supporting the fire department.[2] Under a statutory authority to purchase fire engines and apparatus of all kinds for the use of the fire department of a city, the board of fire commissioners having charge of such matters may purchase hose carriages.[3]

§ 34. Illustration of wrongfully incurred liability.— Where the sum of $1,500 had been voted by a school district of Wyoming for contingent expenses, the Supreme Court of that state held that the purchase of a steam-heating apparatus for a sum largely in excess of that amount was not within the power of the

[1] Second National Bank of New Albany *v.* Town of Danville, (1878) 60 Ind. 504; Sheffield School Township *v.* Andress, 56 Ind. 157. See upon this subject, generally, Evansville, etc., R. R. Co. *v.* City of Evansville, 15 Ind. 395; City of Indianapolis *v.* Miller, 27 Ind. 394; Thompson *v.* City of Peru, 29 Ind. 305. On the principle, Halstead *v.* Board of Comrs. of Lake County, 56 Ind. 363.

[2] Green *v.* City of Cape May, (1879) 41 N. J. Law, 45. It was said in the opinion: "The power to suppress fires, etc., would be nugatory without the power to obtain the means by which the suppression can be effected. The authority to prescribe the power and duties of firemen and fire engineers implies that there shall be apparatus, in the management of which duties shall arise and become the subject of municipal regulation. The power to organize a fire department unaccompanied with the power to equip the department with apparatus would be as futile as the privilege of raising an army without the power to provide weapons or subsistence. The power to do either would imply the power to effectuate the intent involved in the grant by the execution of its incidents. The contracts for the purchase of apparatus are clearly among the incidents of the grant. The power to purchase fire engines has been, in several states, sustained under the authority of the city to make police regulations for public safety, which, it is held, confers the power to take measures for the prevention of fires. Whether the power to suppress fires arises from the general safety clause of the charter or from express grant, it carries with it the right to purchase fire engines. 1 Dill. on Mun. Corp. § 94."

[3] Leonard *v.* Long Island City, (1892) 47 N. Y. St. Rep. 761; s. c., 20 N. Y. Supp. 26.

district board.[1] The court held the warrant issued by the school district for a steam-heating apparatus to be void for another reason that it was in violation of the statute of congress limiting the amount of indebtedness to be incurred by every political or municipal corporation, county or other subdivision of the territories of the United States to an amount not exceeding a certain percentage on the value of taxable property therein.[2]

§ 35. Purchase of cemetery grounds.— A charter of a municipal corporation conferring the power to purchase fire

[1] School District No. 3 in Carbon County *v.* Western Tube Co., (Wyo. 1895) 38 Pac. Rep. 922. It was said by the court: "Certainly our statute does not permit the contracting of debts far in excess of the appropriation made for contingent purposes for that year, and we doubt that such authorized expenditures would be countenanced anywhere in the absence of a statute giving a district school board express powers to contract for the district beyond the annual appropriations made by the annual school meeting, where such meeting is made the source of the power of taxation. It would authorize the creation of a floating indebtedness which should bind the district the same as a bonded indebtedness permitted by an act of the legislature. In some of the states the district board or some of its members are authorized either in express statutory terms or by implication, where the board or officer are charged with certain duties, to incur expenses for the district in limited sums for specific purposes, but this power to bind the district is strictly limited to the purposes named in the statutes. Conklin *v.* School District, 22 Kans. 521; School District *v.* Snell, 24 Mich. 350; Gibson *v.* School District, 36 Mich. 404; Johnson *v.* School District, 67 Mo. 319."

[2] School Dist. No. 3 of Carbon County *v.* Western Tube Co., (1895) 38 Pac. Rep. 922; Acts 49th Cong. (1st Sess.) chap. 818, § 4. It was urged before the court that the debt attempted to be incurred by the district board for the heating apparatus was a necessary one, and that the very existence and maintenance of the public schools required that they should be kept open and the pupils comfortably seated and warmed. The court said to this: "But this question is settled. The provisions of the act of congress were probably borrowed from the Constitution of Illinois, which contains a similar restriction, a limitation which has been judicially interpreted. The clause shall not become indebted 'in any manner or for any purpose' in the Illinois Constitution is construed to mean just what it says, and not to permit an exception that would allow a public corporation to incur indebtedness for supplies to meet its ordinary wants and necessities, an exception which the framers of the Constitution did not see fit to make and which the courts have no power to insert. Prince *v.* City of Quincy, 105 Ill. 138, 143, 216; City of Springfield *v.* Edwards, 84 Ill. 626; Law *v.* People, 87 Ill. 385. The same principle is sustained by the Supreme Court of the United States in construing a similar construction in the Constitution of Colorado. Lake Co. *v.* Rollins, 130 U. S. 662; s. c., 9 Sup. Ct. Rep. 651; Lake Co. *v.* Graham, 130 U. S. 674; s. c., 9 Sup. Ct. Rep. 654. It makes no difference for what purpose or in what manner the debt was created; if in excess of the statutory or constitutional limit it is wholly void."

apparatus, cemetery grounds, to establish markets and other things, for the execution of which power money would be a necessary means, in the absence of any positive restriction, confers the power to borrow money as an incident to the execution of such general powers.[1] A power of taxation conferred in the charter cannot be deemed to exclude the power of borrowing.[2] This city having contracted to purchase a cemetery lot, and pay for the same by its corporate bonds, it was held, having acted within the powers conferred by its charter, could not be prevented by a subsequent act of the legislature forbidding the issuing of bonds.[3]

§ 36. Erection of crematory for garbage, etc.— The Supreme Court of Wisconsin has held that, under the general power given by the statutes of Wisconsin to prevent or abate nuisances, a village board may contract for the building of a crematory for garbage, dead animals, etc.[4]

[1] Mills *v.* Gleason, (1860) 11 Wis. 470.

[2] Ibid.; Clarke *v.* School District, 3 R. I. 199.

[3] Mills *v.* Gleason, (1860) 11 Wis. 470; see State *v.* Common Council, 7 Wis. 688; Smith *v.* Appleton, 19 Wis. 468.

[4] Kilvington *v.* City of Superior, (1892) 83 Wis. 222. The court said: "The power 'to prevent or abate nuisances'— that which occasions public hurt or inconvenience — is necessarily a very broad and comprehensive one, and essential, if not indispensable, to the purpose for which the village was created. It would hardly be questioned by any one that if garbage, manure, or dead animals were found within the village, in the interest of good order, cleanliness or public health, the board of trustees would have power to abate such nuisances by removing or otherwise making suitable disposition of them. To this end, it might provide for destroying them, instead of fouling the waters of a lake or stream of water with them, to be again cast up, to the prejudice of the public, or depositing them where they would create a new nuisance. To this end, if a garbage crematory becomes necessary, the board may, within a fair and *bona fide* exercise of their discretion, contract for its construction, and the village will be bound by the contract. Speaking of the powers of such corporations, in Spaulding *v.* Lowell, 23 Pick. 71, 74, SHAW, Ch. J., says: 'They can exercise no powers but those which are conferred upon them by the act by which they are constituted, or such as are necessary to the exercise of their corporate powers or duties and accomplishment of the purposes of their association.' French *v.* Quincy, 3 Allen, 9, 12. This rule has been affirmed in this state, with the just qualification that such corporations may resort to the usual and convenient means of executing the powers granted; that is to say, as applied to this case, that the village, in order to prevent or abate nui-

§ 37. Use of private property for sewers.—Under the authority to construct sewers as incident to the general right of a municipal corporation to maintain streets and highways,[1] the governing authorities of a city may contract for a right to construct a sewer through private property and bind the city for the cost by way of damages agreed upon by the authorities and the owners of the private property.[2]

§ 38. Detection of criminals.—Municipal corporations, when not authorized to levy taxes to pay the expenses of detecting and bringing to justice persons guilty of crimes punishable under general laws, cannot through their governing board create an indebtedness against the corporation for any such purpose, whether by proclamation, resolution or ordinance.[3]

§ 39. Aiding private corporations.—A municipal corporation cannot become a shareholder or stockholder in a private corporation or borrow money or incur debts to aid extraneous

sances, might resort to such means as were usual and convenient. Mills *v.* Gleason, 11 Wis. 470, 491; Gilman *v.* Milwaukee, 61 Wis. 588, 592; Bell *v.* Platteville, 71 Wis. 139, 142; Meinzer *v.* Racine, 68 Wis. 241, 245. The power to prevent and abate nuisances is an express grant of power, and not an implied one; and 'it has long been an established principle in the law of corporations that they may exercise all their powers within the fair intent and purpose of their creation which are reasonably proper to give effect to powers expressly granted. In doing so, unless restricted in this respect, they must have a choice of means adapted to ends, and are not confined to any one mode of operation,' and their discretion in this respect cannot be revised or interfered with by the courts, except where the substantive power is exceeded, or fraud is shown, or there is a manifest invasion of private rights. Dill. Mun. Corp. §§ 91, 94, and cases cited; Benson *v.* Waukesha, 74 Wis. 31, 39; Kelley *v.* Milwaukee, 18 Wis. 83, 85; Schanck *v.* Mayor, 69 N. Y. 444; Spaulding *v.* Lowell, 23 Pick. 17, 80. It was not necessary, therefore, that there should have been express power conferred on the village to build, or contract for building, the crematory. The village board might contract for it as a means adapted to the end of preventing or abating nuisances, and as a health measure, and so within the general purpose for which the village was organized."

[1] Cone *v.* City of Hartford, 28 Conn. 363, 366; Fisher *v.* Harrisburg, 2 Grant (Pa.), 291; Stoudinger *v.* City of Newark, 28 N. J. Eq. 187.

[2] Leeds *v.* City of Richmond, (1885) 102 Ind. 372. In the power granted to a city to construct a sewer outside of its limits, when necessary to afford an outlet for sewers within, is included the power to agree with owners of lands as to terms of their occupancy. Little *v.* City of Rochester, (1883) 17 N. Y. Wkly. Dig. 513.

[3] Murphy *v.* City of Jacksonville, (1881) 18 Fla. 318. Whether or not town trustees could bind a town by offering a reward for the apprehension of a felon who had been guilty of homicide in the town has been questioned in Kentucky. Lee *v.* Trustees of Flemingsburg, (1838) 7 Dana (Ky.), 28.

objects, unless the power be expressly granted.[1] There is no power conferred upon a city to purchase real estate within its corporate limits designed for the benefit of an agricultural society that its annual fairs should be held therein, by a provision in its charter giving the council "full power and authority to purchase, and provide for the payment of the same, all such real estate and personal property as may be required for the use, convenience and improvement of the city."[2] Even with power, granted by

[1] Mayor *v.* Wetumpka Wharf Co., 63 Ala. 611; Low *v.* Marysville, 5 Cal. 214; Douglass *v.* Placerville, 18 Cal. 643.

[2] City of Eufaula *v.* McNab, (1880) 67 Ala. 588. Somerville, J., speaking for the court, said: "It may be conceded that if the land in question had been purchased for an exclusively *public use*, as being designed for dedication to a purpose within the usual scope of municipal governments, it might be a proper exercise of corporate power under the above section, and the validity of the contract of purchase could not be affected or rendered invalid by any subsequent diversion of the land to unauthorized uses, not shown satisfactorily to have been mutually intended at the time of the purchase. 2 Dill. on Mun. Corp. § 444; Weismer *v.* Village of Douglas, 64 N. Y. 91; s. c., 21 Am. Rep. 586. But the terms of the charter are imperative that such property must be '*required* for the use, convenience and improvement of the city.' Collateral advantages, incidentally resulting in the promotion of the city's commercial or business prosperity, will not be sufficient. It is not contemplated or permitted that such property shall be acquired in aid of private enterprise not of a public character, however laudable may be its purpose, or however useful may be its encouragement. As said by Mr. Justice Miller in Loan Association *v.* Topeka, 20 Wall. 655, 660: "It follows that in this class of cases the right to contract must be limited by the right to tax, and if in the given case no tax can lawfully be levied to pay the debt, the contract itself is void for want of authority to make it. The same view was expressed by Brickell, Ch. J., in the N. O. M., etc., R. R. *v.* Dunn, 51 Ala. 128, 136, where the following language is used: 'The power of taxation thus conferred (by the charter) must be limited and confined strictly to the purposes for which the corporation is created. The revenues derived from the exercise of this power must be faithfully applied to these purposes. The corporate authorities cannot, without a violation of duty and usurpation of power, appropriate the revenues thus produced to any other purposes or objects than such as are fairly expressed or reasonably implied in the charter. It is not material what is the character of the object, or how pressing the necessity, or what are the benefits, real or imaginary, which may flow to the city. If not within the purposes of the act of incorporation, there is a want of power in the corporate authorities.' It was said by the Supreme Court of Maine in Allen *v.* Inhabitants of Jay, 60 Me. 124, that 'taxation by the very meaning of the term implies the

its charter, in a city to aid in the construction of improvements partaking of a public character, the city could not, in the exercise of the power, contract to pay money, or to appropriate its revenues to aid in constructing the works of a private corporation.[1] There being no provision in the Constitution of West Virginia authorizing the levying of taxes to be used to aid private persons in conducting a private manufacturing business, the Supreme Court of the United States held that the legislature had no power to authorize a city of that state to issue its bonds for the purpose of lending them to persons engaged in manufacturing; the act, therefore, was invalid and all bonds issued under its authority were, as against the city, void.[2] The Supreme Court of Arkansas has held that the common council of a town has no power to appropriate money to aid the building of a court house in such town, as such an act is prohibited by that article of the Constitution of the state that no county, city or town, or other municipal corporation, shall appropriate money or loan its credit to any corporation, institution or individual.[3]

§ 40. Subscription to capital stock of railroad corporations.—Municipal corporations are clothed with no power, outside of express authority granted by statute, to subscribe to the stock of private corporations.[4] And if such authority be given by the legislature the mode and procedure prescribed by the statute must be strictly followed.[5] The legislature of a state may grant to municipal corporations power to subscribe to the capital

raising of money for *public uses*, and excludes the raising it for *private* objects and purposes.' 'I concede,' says BLACK, Ch. J., in Sharpless *v.* Mayor, 21 Pa. St. 147, 168, 'that a law authorizing taxation for any other than *public purposes* is void.' The court cited as sustaining the text: Loan Association *v.* Topeka, 20 Wall. 655; Allen *v.* Inhabitants of Jay, 60 Me. 124; s. c., 11 Am. Rep. 185; Lowell *v.* City of Boston, 111 Mass. 454; s. c., 15 Am. Rep. 39; Hanson *v.* Vernon, 27 Iowa, 28; s. c., 1 Am. Rep. 215; Railroad Co. *v.* Dunn, 51 Ala. 128, Weismer *v.* Village of Douglas, 64 N. Y. 91; s. c., 21 Am. Rep. 586."

[1] San Diego Water Co. *v.* City of San Diego, (1881) 59 Cal. 517.

[2] Parkersburg *v.* Brown, (1882) 106 U. S. 487; s. c., 1 Sup. Ct. Rep. 442.

[3] Russell *v.* Tate, 52 Ark. 541; s. c., 13 S. W. Rep. 130. As to the loaning of its credit by a municipal corporation to a private corporation, forbidden by constitutional provisions of the state, see City of Cleburne *v.* Brown, 73 Tex. 443; s. c., 11 S. W. Rep. 404.

[4] French *v.* Teschemaker, (1864) 24 Cal. 518; Gulf Railroad Co. *v.* Miami County, 12 Kans. 482.

[5] French *v.* Teschemaker, (1864) 24 Cal. 518.

stock of private corporations formed to carry out such public improvements as tend to increase the trade and business interests of the municipality.[1] In the absence of constitutional prohibition the legislature of a state may authorize municipal corporations to aid in the construction of railroads.[2] And a statute authorizing municipalities to aid in the construction of a railroad is not in conflict with the provisions of a State Constitution forbidding a loan of the credit of the state to private persons or corporations, and forbidding the state subscribing to the stock of any corporation, or from being interested in any work of internal improvement, and forbidding any person being deprived of his property without due process of law.[3] There is no ground for a constitutional objection to the grant of power by the legislature to a city to subscribe to stock of a railroad company in the fact that such company is a foreign corporation and that its road terminates at a point in another state from which it runs a line of boats to the city issuing its bonds in aid of the company.[4] The statute of Arkansas authorizing counties "having or controlling internal improvement funds, or credits granted to it by the state," to subscribe to the capital stock of any valid and duly organized railroad, has been held not to confer power upon counties to subscribe for stock in a railroad company and issue bonds of the county in payment for it which might by any possibility become a proper charge upon the taxpayers of the county.[5] The court adhered to this decision in a later case and held generally that a county or other municipal corporation had no power, independently of an express grant of authority, to subscribe for stock in a railroad company and issue bonds in payment of the subscription.[6] The Iowa Supreme Court has held that to aid in the construction of a railroad was not a *public purpose* within the meaning of a provision in the charter of a city that "whenever, in the opinion of the city council, it is expedient to borrow money for any *public purpose* the question shall be submitted," etc., and

[1] City of Bridgeport *v.* Housatonuc R. R. Co., (1843) 15 Conn. 475.

[2] Taylor *v.* City of Ypsilanti, 11 Fed. Rep. 925.

[3] Ibid. As to the power of Kansas cities under the legislation of that state to become interested in railroad enterprises and to issue railroad aid bonds, see Bard *v.* City of Augusta, 30 Fed. Rep. 906.

[4] Moulton *v.* City of Evansville, 25 Fed. Rep. 382.

[5] English *v.* Chicot County, (1871) 26 Ark. 454.

[6] Hancock *v.* Chicot County, (1877) 32 Ark. 575.

there was no power conferred by the charter to borrow money for the purpose of aiding in the construction of a railroad, the power to borrow money conferred upon the city not authorizing the loan of the credit of the city.[1] The Supreme Court of Illinois has recently held that where an act incorporating a railroad company gave power to towns along the line of its road to subscribe to the capital stock of the company, a town along its line, subsequently incorporated by an act of the same session of the legislature, which did not enumerate among the powers of the town the power to subscribe to such stock, could make a valid subscription to such stock, there being no inconsistency between the act incorporating the railroad company and the one incorporating the town.[2]

[1] Chamberlain *v.* City of Burlington, (1865) 19 Iowa, 395.

[2] Hutchinson *v.* Self, (1894) 153 Ill. 542; s. c., 39 N. E. Rep. 27. As to the constitutionality of acts authorizing municipal subscription to stock of railroads, etc., see Commonwealth ex rel. Armstrong *v.* Perkins et al., Commissioners of Allegheny County, (1862) 43 Pa. St. 400. As to power of municipal corporations under the Constitution and laws of Colorado to make donations or subscribe to capital stock of private corporations, see Colorado C. R. R. Co. *v.* Lea, 5 Col. 192; Packard *v.* Jefferson County, 2 Col. 338; People *v.* Pueblo County, 2 Col. 360. In Kentucky: W. & M. S. T. R. Co. *v.* Clark Co. Ct., (1860) 3 Metc. 144; Shelby Co. Ct. *v.* C. & O. R. R. Co., (1871) 8 Bush, 216; Mercer Co. Ct. *v.* S. M. & H. T. Co., (1874) 19 Bush, 257; Mercer Co. Ct. *v.* Ky. River Navigation Co., (1871) 8 Bush, 307; C. & O. R. R. Co. *v.* Barren Co. Court, 8 Bush, 215; Foreman *v.* Murphy, (1870) 7 Bush, 304. Subscription made valid by confirmation by act of the legislature. Shelby Co. Ct. *v.* C. & O. R. R. Co., 8 Bush, 218. Legislature may modify, etc., after a vote is taken and before the actual making of subscriptions. C. & O. R. R. Co. *v.* Barren Co. Court, (1874) 10 Bush, 610. Constitutionality of acts authorizing subscriptions settled. Shelby Co. Ct. *v.* C. & O. R. R. Co., (1871) 8 Bush, 215; Tyler *v.* E. & P. R. R. Co., (1872) 9 Bush, 515; Bullock *v.* Curry, 2 Metc. 174; Allison *v.* L. H. C. & W. R. Co., 9 Bush, 248; Shelbyville Trustees *v.* S. & E. T. Co., 1 Metc. 57. Under what circumstances the legislature may repeal acts granting authority to subscribe to capital stock of railroad company. C. & L. R. R. Co. *v.* Kenton County Court, (1851) 12 B. Mon. 150; M. T. Co. *v.* How, (1854) 14 B. Mon. 432. In Missouri: Osage Valley & Southern Kansas R. R. Co. *v.* Morgan County Court, (1873) 53 Mo. 156; Rubey *v.* Shain, (1873) 54 Mo. 207. As to the power of the legislature to authorize such subscriptions, see St. Joseph & Denver City R. R. Co. *v.* Buchanan County Court, 39 Mo. 485; State *v.* Saline County Court (1870) 45 Mo. 242. As to raising money to aid in the construction of a railroad, see Stevens *v.* Anson, 73 Me. 489. In Pennsylvania R. R. Co. *v.* City of Philadelphia, (1864) 47 Pa. St. 189, the power to invest its stocks, money or credit directly or indirectly in aid of a steamship line between this city and foreign ports, in the absence of special legislation authorizing it, was denied to this city by the Supreme Court of Pennsylvania. See chap. "Municipal Aid."

[1] Mayor & Aldermen of Wetumpka *v.* Winter, (1857) 29 Ala. 651. It appeared in this case that certain bonds had been issued by a city under statutory authority, and it was provided by the statute that "the money arising from the sale of said bonds may be appropriated under the supervision and direction of the mayor and aldermen of [the city], for any purpose of internal improvement for the benefit of the citizens of [the city]." These bonds were used to aid in the construction of a plank road which was to enter the city from an outside point. There was a contention that this was an improper use of the bonds on the part of the city; that inasmuch as the powers of municipal corporations are conferred for their well-being and generally confined to police and sanitary regulations within the chartered limits of such corporations, the proper construction of the words "internal improvements" in the statutes was that they applied to no works except within the city limits. The Supreme Court of Alabama construed the words, however, to authorize the city to pledge its credit, and thereby raise money to aid in the construction of some work of the kind generally referred to as internal improvements in the general acceptation of the words as a means of improving the commerce of the city, and thereby benefiting its citizens. As to the power of the legislature to confer upon municipal corporations the power to lend its credit in aid of railroad or other improvements, see Fielder *v.* M. & E. R. R. Co., 51 Ala. 178.

[2] Gibbons *v.* Mobile & Great Northern R. R. Co., (1860) 36 Ala. 410, adhering to the doctrine declared in Stein *v.* Mayor, Aldermen, etc., of Mobile, (1854) 24 Ala. 591, that although the only legitimate object of taxation is the support and maintenance of government, yet this purpose embraces a wider range than the mere machinery employed in its administration; that the power authorizes the employment of the necessary appliances to augment the aggregate wealth and prosperity of the inhabitants of the city; and that this may be accomplished by providing outlets for commerce, opening channels of

§ 41. Power of the legislature as to corporations in such matters.— It is in the power of the legislature of a state to confer on municipal corporations larger powers than would be implied from the general purposes of their creation, and when the legislature of a state, in express terms authorizes cities or towns to subscribe for stock in an enterprise, of the kind usually known as internal improvements, canals, railroads and plank-roads, for instance, the contract of such cities or towns, made pursuant to the statute, is binding upon them.[1]

§ 42. Constitutionality of legislation authorizing such aid.—The Supreme Court of Alabama has sustained the acts authorizing cities to aid by subscription to stock and issue of bonds in the construction of railroads as constitutional.[2] In an

early leading case in Wisconsin, involving the lending of its credit by the issue of its bonds in aid of a railroad company by a city of that state, the constitutionality of the act granting the power to the city to do so was vigorously attacked on all points. The Supreme Court, however, sustained the constitutionality of the act, holding that the constitutional provisions that the "credit of the state shall never be given or loaned in aid of any individual, association or corporation," and that "the state shall never contract any debt for works, of internal improvement, nor be a party in carrying on any such works were limitations upon the state alone and did not prohibit the legislature to authorize counties, towns and cities to loan their credit or contract debts for works of internal improvement; that the Constitution in another place recognized the power of municipal corporations to loan their credit and required the legislature simply to restrict it.[1] The legislature may authorize a town to subscribe for the stock of a railroad company and to incur indebtedness for making internal improvements; and the corporation would be liable for the payment of such indebtedness.[1]

inter-communication with other parts of the state, etc. Mayor, etc., of Wetumpka *v.* Winter, 29 Ala. 651; Sharpless *v.* Mayor, etc., 21 Penn. St. 147; Louisville & Nashville R. Co. *v.* County Court, 1 Sneed, 637. In Stein *v.* Mayor, etc., *supra*, the court reviewed as to the power as well as purposes of taxation the following cases, arising in different states, to wit: Battle *v.* Corporation of Mobile, 9 Ala. 234; Intendant of Marion *v.* Chandler, 6 Ala. 899; State *v.* Estabrook, 6 Ala. 653; Nichol *v.* Mayor of Nashville, 9 Humph. 252; Hope *v.* Deaderick, 8 Humph. 1; Commonwealth *v.* McWilliams, 11 Penn. St. 61; Parker *v.* Commonwealth, 6 Barr, 507; Commonwealth *v.* Judges, etc., of Lebanon County, 8 Barr, 391; Commonwealth *v.* Painter, 10 Barr, 214; Goddin *v.* Crump, 8 Leigh, 120; Burgess *v.* Pue, 2 Gill, 19. In Winter *v.* City Council of Montgomery, (1880), 65 Ala. 403, the Supreme Court of Alabama sustained the act which in this case authorized the subscription by this city to stock in a matured company and issue of bonds in payment for it, and declared this rule: "To justify a court in pronouncing a statute void, it must be apparent that it is an exercise of powers not legislative — of power committed to one or more of the other departments of the government, or that it is violative of some provision of the Constitution, state or federal. Whether the policy of the statute is sound — whether it will promote the public good — whether it is in harmony with natural right or will obstruct justice are not judicial questions. Dorman *v.* State, 34 Ala. 216."

[1] Clark *v.* City of Janesville, (1859) 10 Wis. 136, following State ex rel. Dean *v.* City of Madison, 7 Wis. 688. See, also, Watertown *v.* Cady, 20 Wis. 501. In Bushnell *v.* Beloit, (1860) 10 Wis. 195, the same court has declared that the Constitution of Wisconsin clearly recognized the principle that municipal corporations may be clothed with power to "borrow money," "contract debts" and to "loan their credit;" and that the legislature being required to restrict such corporations in the exercise of such powers was an

§ 43. In what respect the power of a municipality is restricted.— A city, the charter of which fully empowers and

admission that the power existed. See Foster *v.* Kenosha, 12 Wis. 616.

[1] Bushnell *v.* Beloit, (1860) 10 Wis. 195. See, also, Brodhead *v.* Milwaukee, 19 Wis. 624; State ex rel. Carpenter *v.* Beloit, 20 Wis. 79; Whiting *v.* Railroad Co., 25 Wis. 167; Bridgeport *v* Housatonuc R. R. Co., 15 Conn. 475; Sharpless *v.* Mayor, etc., 21 Penn. St. 147; Comm. ex rel. Thomas *v.* Comrs. Allegheny Co., 7 Am. Law Reg. 92; Talbot *v.* Dent, 9 B. Mon. 526; Slack *v.* Maysville & Lexington R. R. Co., 13 B. Mon. 1; Cheaney *v.* Hooser, 9 B. Mon. 250; Goddin *v.* Crump, 8 Leigh, 120; Nichol *v.* Mayor, etc., Nashville, 9 Humph. 252; Cincinnati R. R. Co. *v.* Clinton County, 1 Ohio St. 77; Steubenville & Ind. R. R. Co. *v.* North Township, 1 Ohio St. 105; Shaw v. Dennis. 5 Gilm. (Ill.) 405; Ryder *v.* Alton & Sangamon River R. Co., 13 Ill. 516, Dubuque County *v.* D. & P. R. R. Co., 4 G. Gr. 1; Vicksburg, Shreveport & Texas R. R. Co. *v.* Ouachita, 11 La. Ann. 649; Parker *v.* Scogin, 11 La. Ann. 629; City of Aurora *v.* West, 9 Ind. 74. As to the constitutionality of legislative enactments authorizing a subscription to stock, etc., in aid of railroads, see Stewart *v.* Board of Supervisors of Polk County, (1870) 30 Iowa, 9; Goddin *v.* Crump, 8 Leigh, 120; Starin *v.* Genoa, 29 Barb. 442; Bank of Rome *v.* Village of Rome, 18 N. Y. 38; Prettyman *v.* Supervisors, etc., 19 Ill. 406; Robertson *v.* Rockford, 21 Ill. 451; Johnson *v.* Stark Co., 24 Ill. 75; Pattison *v.* Yuba Co., 13 Cal. 175; Blanding *v.* Burr, 13 Cal. 343; Hobart *v.* Supervisors, 17 Cal. 23; Taylor *v.* Newberne, 2 Jones Eq. (N. C.) 141; Caldwell *v.* Justices of Burke. 4 Jones Eq. (N. C.) 323; Louisville, etc., R. R. Co. *v.* Davidson, 1 Sneed, 637; Nichol *v.* Mayor, etc., of Nashville, 9 Humph. 252; Railroad Co. *v.* Comrs. of Clinton Courty, 1 Ohio St. 77; Trustees of Paris *v.* Cherry, 8 Ohio St. 564; Cass *v.* Dillon, 2 Ohio St. 607; State *v.* Comrs. of Clinton County, 6 Ohio St. 280; State *v.* Van Horne, 7 Ohio St. 327; State *v.* Trustees of Union, 8 Ohio St. 394; Trustees, etc., *v.* Shoemaker, 12 Ohio St. 624; State *v.* Comrs. of Hancock, 12 Ohio St. 596; Powers *v.* Dougherty County, 23 Ga. 65; San Antonio *v.* Jones, 28 Tex. 19; Commonwealth *v.* McWilliams, 11 Penn. St. 61; Moers *v.* City of Reading, 21 Penn. St. 188; Slack *v.* Railroad Co., 13 B. Mon. 1; Talbot *v.* Dent, 9 B. Mon. 526; City of St. Louis *v.* Alexander, 23 Mo. 483; City of Aurora *v.* West, 9 Ind. 74; Cotton *v.* Comrs. of Leon. 6 Fla. 610; State ex rel. Copes *v.* Charleston, 10 Rich. (S. C.) 491; Comrs. of Knox County *v.* Aspinwall, 21 How. 539; Comrs. of Knox County *v.* Wallace, 21 How. 546; Zabriskie *v.* Railroad Co., 23 How. 381; Amey *v.* Mayor, etc., 24 How. 364; Gelpcke *v.* Dubuque, 1 Wall. 175; Thomson *v.* Lee County, 3 Wall. 327; Rogers *v.* Burlington, 3 Wall. 654; Gibbons *v.* Mobile & G. & Northern R. R. Co., 36 Ala. 410; St. Joseph, etc., R. R. Co. *v.* Buchanan County Court, 39 Mo. 485; State *v.* Linn County Court, 44 Mo. 504; Stewart *v.* Board of Supervisors of Polk County, 30 Iowa, 9; John *v.* C. R. & F. W. R. R. Co., 35 Ind. 539; Ex parte Selma, etc., R. R. Co., 45 Ala. 696; Stockton & Visalia R. R. R. Co. *v.* Stockton, 41 Cal. 147.

authorizes its city council "to make, ordain and enact such laws and regulations (not contrary to the Constitution and laws of this state) as may be deemed necessary in relation to the streets and highways, public buildings and powder magazines, and every other matter and thing which they may deem necessary for the good order and welfare of said city," is not authorized to construct or aid in constructing a plank road or bridge beyond the corporate limits of said city.[1]

[1] City Council of Montgomery *v.* Montgomery & Wetumpka Plank Road Co., (1857) 31 Ala. 76, holding a loan of the city funds to this company for construction of its road and a bridge beyond the limits of the city to have been unauthorized and void; STONE, J., said: "We find no express authority [in the charter of this city] to enter into the contract declared on; neither is the exercise of such power necessary to carry into effect any of the expressly granted powers; nor was the exercise of the power under consideration a necessary means of effecting the purpose for which this corporation was created. * * *" As to the effect of the general words in the charter it was said: "In the case of Beaty *v.* Lessee of Knowler, 4 Pet. 152–171, the Supreme Court of the United States held the following language: 'The provision in the 10th section that the 'directors shall have power to do whatever shall appear to them necessary and proper to be done for the well ordering of the interest of the proprietors, not contrary to the laws of the state,' was not intended to give unlimited power, but the exercise of a discretion within the scope of the authority conferred. If the words of this section are not to be restricted by the other provisions of the statute, but to be considered according to their literal import, they would vest in the directory a power over the land only limited by their discretion. They could dispose of the land and vest the proceeds in any manner which they might suppose would advance the interest of the proprietors. It is only necessary to state the consequence to show the danger of such a construction.'" Citing The People *v.* Utica Ins. Co., 15 Johns. 358, 383; Stetson *v.* Kempton, 13 Mass. 272, 278, 279; State of Ohio *v.* Washington Social Library Co., 11 Ohio, 96; Ang. & Ames on Corp. (3d ed.) 84, 85, 86. The language found in the charter which was construed in the case of Beaty v. Lessee of Knowler, *supra*, strikingly resembles the clause from the act incorporating the city of Montgomery, which we are considering. The grant of power in the one case is that "the *directors shall have power to do whatever shall appear to them to be necessary and proper to be done*," etc. In the other it embraces "*every other matter and thing which they may deem necessary for the good order and welfare of said city.*" In this case, as in the case from 4 Pet. *supra*, if the words of the charter "are not to be restricted by the other provisions of the statute, but to be considered according to their literal import, they would vest in the corporate authorities a power * * * only limited by their discretion." We cannot believe it was the intention of the legislature to confer on the city council of Montgomery "unlimited power," but only to grant to that body the right to exercise "a discretion within the scope of the authority conferred. In other words, we limit the words, 'every other matter and thing,' as found in the act, to such subjects as are cognate to the powers expressly conferred."

§ 44. Subscription for less than the amount voted.—When authorized by the legislature to issue bonds which may be delivered to a railroad corporation in payment of a subscription to its capital stock by a municipal corporation, the subscription to stock or issue of bonds may be for less than the amount voted.[1]

[1] Chicago, Kansas & Western R. R. Co. *v.* Ozark Township, (1891) 46 Kans. 415. The court cites Turner *v.* Woodson County, 27 Kans. 314, and then said: "This question has also been virtually decided * * * by the Supreme Court of Alabama [in] Winter *v.* City Council of Montgomery, 65 Ala. 403; s. c., 7 Am. & Eng. R. R. Cas. 307. This case is as nearly in point, as nearly applicable, as nearly analogous to the present case as it could well be, and we know of no authority to the contrary, and the principle enunciated in the cases cited is substantially that when authority is given to the officers of a public corporation, by an election or otherwise, to issue a certain amount of the bonds of the corporation, the officers will have the power and the right, wherever there is a sufficient reason therefor, to issue a less amount of the bonds of the corporation." The court further on in the opinion said: "The object of the law in permitting public corporations to subscribe for stock in railroad companies, and to issue their bonds in payment therefor, is not intended as a business transaction like that consummated by an individual when he purchases stock and pays therefor in money or in something else. It is merely for the purpose of procuring greater facilities for travel and transportation for the general public which is always considered as a public purpose and not merely as a private purpose, enterprise or business transaction. The act itself authorizing counties, townships and municipal corporations to subscribe for stock in and to issue bonds to railroad companies, is entitled, 'An act to enable counties, townships and cities to aid in the construction of railroads,' etc. Laws of 1876, chap. 107. This shows that the main object of the act was to enable counties, townships and cities '*to aid in the construction of railroads*,' and was not to permit such corporations to engage in such transactions as a mere business venture, or as an investment in stock or a speculation in bonds and stocks." Twenty years ago it was said by this court in the case of Comrs. of Leavenworth Co. *v.* Miller, 7 Kans. 479, 528, 529, 532, among other things, as follows: "If a railroad company is purely a private corporation, and if the construction and operation thereof is purely a private purpose, neither the government nor any municipal corporation has any right to become a stockholder therein. Governments were not organized for the purpose of engaging in private enterprises or private business, but only for the transaction and promotion of public affairs. Even if the purchase of stock in a railroad company should be a paying transaction as an investment (which unfortunately for counties and municipal corporations it is not), still a governmental organization would have no right for that reason alone to engage in it, for governmental organizations are not created for purposes of speculation, nor are they created for the purpose of promoting the general welfare of the individual members thereof

§ 45. The effect of subsequent legislation upon such a subscription.— A city in Georgia, the mayor and council of which had been by statute empowered "to borrow money and contract loans, not to exceed $200,000, for the use of the city * * *; and to pledge the funds or property of the corporation * * * and the commons thereof, for the redemption of such loan or loans, and also shall have power to purchase any real or personal estate for the use and benefit of the corporation, * * *" subscribed for shares of stock of a railroad company. After the subscription the city authorities were by statute "empowered to contract a further loan of the same amount, over and above the amount already borrowed, and that the town commons and public property of the city be pledged for the payment of the same." The preamble to this last act referred to the passage of the first act, concluding: "And whereas, that sum has been already borrowed *and vested in stocks for the purposes of internal improvement.*" The Supreme Court of Georgia held that the effect of this last

or citizens. The increased facility for travel and transportation is the main object in the creation of railroads, and this it is which constitutes a railroad a public purpose. All other benefits, though belonging of right to the public, are simply incidental." Pages 528 and 529. "The opening of hotels, the running of stage coaches, hacks, drays, etc., have never been considered as incumbent upon governments. Governments have never undertaken to keep hotels, run stage coaches, etc., and it has never been considered that there was any moral or legal obligation resting upon them to do so. But the duty of opening highways, canals and other like improvements for the accommodation of travel and commerce, has always been considered most binding upon all governments." Page 532. In the case of Winter *v.* City Council of Montgomery, above cited, the Supreme Court of Alabama used the following, among other language: "We do not discover that the city council varied the propositions which were submitted to and approved by the voters at the election. The proposition was, when fairly construed, that the city should extend aid to the railroad company by the issue of its bonds to an amount not exceeding one million of dollars, which were to be employed in building and equipping the road. It was not pecuniary gain, not any of the advantages which would accrue to an individual from membership in the railroad company that formed a motive or inducement for clothing the city with power to aid in the construction of the road. The benefits which would result to the commerce and industry of the city, the increased facilities of access to it, were the purposes for which the power was conferred. If these could be secured without involving the city in a debt of one million of dollars, it was not only within the power, but it was the duty of the city council to secure them for the least practicable sum. The power to create the larger includes the power to create the lesser debt. *Omne majus continet in se minus.*" 7 Am. & Eng. R. R. Cas. 319.

statute, by necessary implication was to ratify and make valid the subscription for the shares of stock of the railroad corporation.[1]

§ 46. Statutory authority to construct a railroad.— The Supreme Court of Ohio has sustained the constitutionality and validity of the act of the legislature of that state, the general scope and purpose of which was to authorize cities of the state of a certain population to construct a line of railroad leading therefrom to any other terminus in the state, or in any other state, through the agency of a board of trustees, etc., with authority to such board of trustees to borrow a sum of money to a limited amount, and to issue bonds of the city, secured by a mortgage upon the railway and its net income, with a pledge of the faith of the city to levy a tax sufficient, with the net income of the road, to pay the interest upon and provide a sinking fund for the payment of the bonds.[2]

§ 47. Constitutional provisions construed.— The constitutional provision in Kentucky that no act of the legislature authorizing the creation of any debt on behalf of the commonwealth shall become effective until it has been submitted to the people at a *general* election, and shall have received a majority of all

[1] Winn *v.* City Council of Macon, (1857) 21 Ga. 275.

[2] Walker *v.* City of Cincinnati, (1871) 21 Ohio St. 14. Scott, Ch. J., said: "That it is within the legitimate scope of legislative power to authorize a municipality of the state to aid in the construction of a public improvement, such as a railroad, by becoming a stockholder in a corporation created for that purpose, and to levy taxes to pay the subscription, must be regarded as fully settled in this state by repeated adjudications. In the case of C., W. & Z. R. R. Co. *v.* Comrs. of Clinton County, 1 Ohio St. 77, the subject was very fully considered; and it was held that as the state may itself construct roads, canals and other descriptions of internal improvements, so it may employ any lawful means and agencies for that purpose, among which are private companies incorporated for the construction of such improvements. And it was said that for much stronger reasons counties might be authorized to construct works of a similar kind, of a local character, having a special relation to their business and interests. And, as the state might construct or authorize the counties to construct these works entire, or create corporations to do it entire, it was held that as a question of power each might be authorized to do a part. * * * And if, in the absence of a constitutional prohibition, a municipal corporation may be authorized to aid, by stock subscriptions, in the construction of a railway which has a special relation to its business and interests, upon what principle shall we deny that it can be authorized to construct it entirely at its own expense, when its relation is such as to render it essential to the business interests of the municipality?"

the votes then cast" does not include debts created by a county or other municipal division of the state. Whether tax in aid of the construction of a turnpike for instance shall be levied or not may be submitted to the voters of a county or magisterial district of a county at a *special* election.[1]

§ 48. What is not a work of "internal improvement," in the meaning of Nebraska statute.— A steam grist mill is not a work of internal improvement within the meaning of the statute of Nebraska which authorizes counties, cities and precincts of organized counties "to issue bonds to aid in the construction of any railroad or other work of internal improvement."[2]

[1] Walton *v.* Riley, (1887) 85 Ky. 413; s. c., 3 S. W. Rep. 605. See Slack *v.* Maysville & Lexington R. R. Co., (1852) 13 B. Mon. 1. In People ex rel. McCagg v. Mayor, Comptroller & City Clerk of the City of Chicago, (1869) 51 Ill. 17; s. c., 2 Am Rep. 278, it was held that the legislature might be regarded as prohibited by the clause of the State Constitution which prohibited the state from creating a debt exceeding $50,000 without the consent of the people, manifested by a vote at a general election, from forcing one of the municipalities of the state to incur debts for an amount larger than $50,000 without the consent of the people of such municipal division of the state. The court said: "What is the real value of this provision of the Constitution if the legislature, inhibited from incurring a debt beyond fifty thousand dollars on behalf of the state, may force a debt tenfold or one hundred-fold greater, for there is no limit to the power upon all the cities of the state? We can perceive none. Where these municipalities become so indebted by compulsion of the legislature the whole state, in its real and substantive, if not in its corporate body, will in truth and fact, be the debtor, for the same power of coercion can be applied to counties and towns, and as the state is made up of cities, counties and towns, the whole state may thus become involved. This provision, then, would be no restriction upon the power to create a debt beyond a certain amount, and would fail of its purpose of protecting the state and its citizens from oppressive burdens."

[2] Osborne *v.* County of Adams, (1882) 106 U. S. 181; s. c., 1 Sup. Ct. Rep. 168, affirming Osborne *v.* County of Adams, (1881) 2 McCrary, 97. The court distinguished Township of Burlington *v.* Beasley, 94 U. S. 310, as follows: "That case arose under a statute of Kansas, which empowered municipal townships in that state to issue bonds for the purpose of building bridges, free or otherwise, or to aid in the construction of railroads or water power by donation thereto, or the taking of stock therein, or for other works of internal improvement." The bonds there in suit were issued to aid in the construction and completion of, and to furnish the motive power for, a steam custom grist mill. It was held that the statute, reasonably interpreted, embraced a grist mill operated by steam, as well as one run by water power; that since municipal aid was authorized for "the construction of * * * water power," the phrase "other works of internal improvement," in the Kansas statute, might be fairly construed as embracing works of the minor class, and consequently as embracing a steam grist mill. The court was somewhat influenced, as plainly appears from its opinion, by decisions of the Supreme Court of Kansas, particularly that of Commissioners of Leavenworth County *v.* Miller, 7 Kans. 479. The present case is different. The only work of internal improvement specially in the Nebraska statute is a railroad, and we are not justified by anything in Township of Burlington *v.* Beasley, or in the decisions of the courts of Nebraska in holding that a steam or other kind of grist mill is of the class of internal improvements which municipal townships in that state are empowered, by the statute in question, to aid by an issue of bonds." For cases holding that the right to erect public buildings, such as jails and court houses, derives no support from such a statute, see Union Pacific Railroad *v.* Lincoln County, 3 Dill. 300; Dawson County *v.* McNamar, 10 Neb. 276.

§ 49. What is such a work.— The Nebraska Supreme Court has held that a water grist mill erected for public use, the rates of toll to be determined by the county commissioners, was a work of internal improvement within the meaning of the statute of that state authorizing counties and cities in that state "to issue bonds or aid in the construction of any railroad or other work of internal improvement * * *."[1]

§ 50. Contracts of guaranty.— The authority to sell negotiable paper held by a city does not carry with it, as an incident, to pay interest on an issue of bonds of the county in aid of a steam grist mill on the ground that there was no statute in that state authorizing the voting of aid to such mills, and that bonds voted in aid of them were invalid, it was said that the decision in the case of Traver *v.* Board, etc., Merrick County, 14 Neb. 327, was based almost entirely upon the statute authorizing the condemnation of private property for the purpose of erecting dams and overflowing lands in order to obtain power to propel mills, and upon the decisions of the Nebraska Supreme Court in Nosser *v.* Seeley, 10 Neb. 460, and Seeley *v.* Bridges, 13 Neb. 547. In Traver *v.* Board, etc., Merrick County, *supra*, it was said on page 334: "There is a clear distinction between aiding the development of the water power of the state — a power which is continuing in its nature, and may be used without cost or expense and must be used at certain points on a stream where a dam can be erected and power obtained — and a mill propelled by steam that must be attended with a continuous cost for fuel, and may at any time be removed to another locality." In County Commissioners *v.* Chandler, (1877) 96 U. S. 205, the Supreme Court of the United States held that a bridge intended for and used as a thoroughfare to be a public highway and, hence, a work of "internal improvement," within the mean-

[1] Traver *v.* Board, etc., of Merrick County, (1883) 14 Neb. 327. Citing as authority for this ruling: Guernsey *v.* Burlington Township, 4 Dill. 372, 375; Township of Burlington *v.* Beasley, 94 U. S. 310, 313. In State ex rel. Bowen *v.* Adams County, (1884) 15 Neb. 568, in which the Supreme Court denied a mandamus to compel a levy of a tax

the power to guarantee it.[1] A county in Arkansas cannot be bound by a contract entered into by the county judge guaranteeing payment for goods to be sold one who has a contract for the construction of a turnpike.[2] A municipal corporation authorized by statute to obtain money on loan, on the faith and credit of the corporation, for the purpose of contributing to works of internal improvement, may, under the power granted by the statute, guarantee the payment of the bonds of a railway company.[3]

§ 51. Employment of agents or attorneys.— There is authority in the Revised Statutes of Maine, relating to towns, to expend money "for the necessary town charges," after specifying certain other purposes. Under those words towns may employ a reasonable number of agents or attorneys to advance or protect the rights of towns before any legally constituted tribunal;[4] but they do not authorize a town to raise and expend money to send lobbyists before the legislature.[5] The board of directors of schools in Louisiana have authority to constitute or defend suits, and the right to incur liability for the costs of such suits follows, as a matter of course.[6] Reasonable attorney's fees in an action against village trustees to enjoin the collection of a tax, and defended in good faith, are a proper charge against a

ing of the Nebraska statute authorizing cities, counties and precincts in that state to issue bonds in aid of works of "internal improvement."

[1] Carter *v.* City of Dubuque, (1872) 35 Iowa, 416.

[2] Dickinson Hardware Co. *v.* Pulaski County, 55 Ark. 437; s. c., 18 S. W Rep. 462.

[3] City of Savannah *v.* Kelly, (1883) 108 U. S. 184; s. c., 2 Sup. Ct. Rep. 472. Mr. Justice MATTHEWS, speaking for the court, said that the fact that the money "was not advanced directly to the city, but upon its assurance of repayment to the railroad company, is not a departure even from the letter of the law, much less from its meaning; nor does the fact that the money was advanced partly on the credit of the railroad company diminish the presumed reliance of the purchaser upon that of the city with which it was joined. It is difficult to conceive of language more comprehensive than that employed to embrace *every form of securities in which the faith and the credit of the city might be embodied*, and that in such cases it is not important to the character of the transaction that the money is obtained in the first instance by the railroad company, upon the credit of the city, was directly ruled in Rogers *v.* Burlington, 3 Wall. 654, and affirmed in Town of Venice *v.* Murdock, 92 U. S. 494."

[4] Inhabitants of Frankfort *v.* Inhabitants of Winterport, (1865) 54 Me. 250.

[5] Ibid.

[6] Fisher *v.* Board of Directors of City Schools of New Orleans, (1892) 44 La. Ann. 184; s. c., 10 So. Rep. 494.

village under a statute authorizing village trustees "to employ an attorney or attorneys for the transaction of any matter requiring legal skill."[1] The Kansas Supreme Court has held that whenever a county is interested at all in the result of a suit, either in its own behalf or in that of some township of the county, and the suit is brought against the legal representatives of the county, and is beyond the limits of the county, as, for instance, a *mandamus* proceeding against the commissioners of a county before the Supreme Court, the county commissioners may, if they choose, employ counsel to take care of the interests of the county.[2] This rule has been declared in Kansas. A county's contract with a counselor at law for services, such as are required by law to be performed by the county attorney, is *prima facie* void.[3] So, also, is a contract by a city for services as an attorney or counselor at law, such as the law requires to be performed by the city attorney.[4]

§ 52. Contracts for legal services — when allowed.— Towns in Illinois have power, at their annual town meetings, to provide for the institution and defense of all suits in which they are interested, and a town meeting may exercise the power by resolution directing the supervisor to procure legal services, and such a contract will be binding on the town should the amount agreed

[1] Squire *v.* Preston, (1894) 82 Hun, 88; s. c., 31 N. Y. Supp. 174.

[2] Thacher *v.* Comrs. of Jefferson County, (1874) 13 Kans. 182; People *v.* Supervisors of N. Y., 32 N. Y. 473; Brady *v.* Supervisors of N. Y., 2 Sandf. 460; Gillespie *v.* Broas, 23 Barb. 370.

[3] Clough *v.* Hart, (1871) 8 Kans. 487.

[4] Ibid. In Hugg *v.* City Council of City of Camden, (1878) 29 N. J. Eq. 6, where there was a city ordinance providing that the solicitor of the city should prosecute and defend all suits, etc., brought by or against the city, the chancellor refused a mandatory injunction to restrain the city from employing other counsel, on the ground of possible irreparable injury to the city, the suit being ready for trial, and on the ground that the complainant's right was not clear. As to the employment of additional counsel to assist corporation counsel or to conduct professionally business in which the city is interested, see Smith *v.* Mayor, etc., of New York, (1875) 5 Hun, 237. As to employment of attorneys by counties, see Brome *v.* Cuming County, 31 Neb. 362; s. c., 47 N. W. Rep. 1050; Board Comrs. Rush County *v.* Cole, 2 Ind. App. 475; s. c., 28 N. E. Rep. 772; Beebe *v.* Board Suprs. Sullivan County, 64 Hun, 377; s. c., 19 N. Y. Supp. 629; Waters *v.* Trovillo, 47 Kans. 197; s. c., 27 Pac. Rep. 822; Butler *v.* Sullivan County, 108 Mo. 630; s. c., 18 S. W. Rep. 1142; Lassen County *v.* Shinn, 88 Cal. 510; s. c., 26 Pac. Rep. 365; Fouke *v.* Jackson County, 84 Iowa 616; s. c., 51 N. W. Rep. 71.

to be paid not be so great, in view of the interests involved, as to indicate bad faith.[1] The Supreme Court of Illinois has upheld as implied, under the legislation of that state with reference to towns, the power of the supervisor of a town to enter into a contract of retainer with an attorney at law to defend a suit instituted against the town upon coupons attached to bonds of the town the validity of which was disputed.[2] In case, in the exercise of their judgment and discretion, the governing board of a county conceive that the interests of the county are involved in a certain question, and take legal measures by suit or otherwise, to advance or protect those interests, the expense incurred thereby becomes a legal charge against the county, notwithstanding the judgment of the court in the matter be that a wrong remedy was adopted, or that there was no remedy at all.[3] A county, under the statutory power "to make all contracts and do all other acts in relation to the property and concerns of the county necessary to the exercise of its corporate powers," may retain attorneys to resist the collection of a tax in the action of a taxpayer who has been induced by the courts to refuse to pay a tax levied by the state for payment of interest on certain county bonds, the object being to test the validity of such bonds.[4] And the statute making it the duty of county boards to take suitable measures for prosecuting and defending all suits to be brought by or against their respective counties, and all suits which it is necessary to prosecute or defend to enforce the collection of all taxes charged on the state assessment, does not take away the right to retain an attorney in such a case.[5]

[1] Town of Mt. Vernon *v.* Patton, (1879) 94 Ill. 65.

[2] Town of Bruce *v.* Dickey, (1886) 116 Ill. 527; s. c., 6 N. E. Rep. 435; Cooper *v.* Delavan, 61 Ill. 96.

[3] Hornblower *v.* Duden, (1868) 35 Cal. 664. In State ex rel. Bermudez *v.* Heath, Mayor of New Orleans, (1868) 20 La. Ann. 172; s. c., 96 Am. Dec. 390, the Supreme Court held the right of the city to employ an attorney at law conversant with city affairs to facilitate the collection of debts due the city was unquestionable as long as it infringed on no rights of the city's officers. The court upheld a contract in this case made with one who was assistant city attorney, to collect all bills for taxes assessed on property as unknown, and all unsatisfied judgments in favor of the city for taxes, on the ground that it neither violated the charter of the city nor conflicted with any of the rights of the assistant city attorney, nor did the duties involved in the contract embrace any of the duties or include any of the emoluments of the office of assistant attorney.

[4] Franklin County *v.* Layman, 145 Ill. 138; s. c., 33 N. E. Rep. 1094, affirming 43 Ill. App. 163.

[5] Ibid.

§ 53. Contracts for legal services — how made.—The common council of a city in Indiana is vested with the power to employ counsel to assist the city attorney to protect the interests of the city; but the contract of employment must be made directly or through an authorized agency.[1] The common council of a city being empowered by its charter to employ counsel cannot delegate this power to the mayor, and any contract made by the mayor with an attorney to act for the city will be void.[2] This power by ordinance to select an attorney for a city conferred upon the common council is a trust created for a public purpose, not assignable at the will of the trustee.[3] The Court of Errors and Appeals for New Jersey has held that the corporate authorities of one of the cities of that state, under the provisions of its charter, had the power to employ associate counsel in defending suits against the corporation or in which the city was interested; and that the board of aldermen were sole judges of the necessity of such employment in any particular case, and the exercise of their discretion in such a matter was not reviewable in that court.[4] The authorities of the city, though under its power to employ associate counsel, were not vested with the right, under the guise of such employment, to withdraw and take out of the hands of the city counsel any particular class or classes of cases and to confide the management of them to others.[5]

§ 54. Where a public corporation is bound for legal services.—An attorney properly employed by a town to perform legal services, being ready and willing to perform the contract, should the proper officers of the town prevent his doing so, will be entitled to recover under the contract.[6] If there is an appeal

[1] Justice *v.* City of Logansport, (1892) 6 Ind. App. 135; s. c., 32 N. E. Rep. 868; City of Logansport *v.* Dykeman, 116 Ind. 15.

[2] City of East St. Louis *v.* Thomas, (1882), 11 Bradw. 283.

[3] Cooley's Const. Lim. 204; City of East St. Louis *v.* Wehrung, 50 Ill. 28; Foss *v.* City of Chicago, 56 Ill. 354; Jenks *v.* Chicago, 56 Ill. 397; L. S. & M. S. Ry. Co. *v.* Chicago, 56 Ill. 454; Jackson Co. *v.* Brush, 77 Ill. 59; Oakland *v.* Carpentier, 13 Cal. 540; Whyte *v.* Mayor, 2 Swan, 364; Darling *v.* St. Paul, 19 Minn. 389; State *v.* Bell, 34 Ohio St. 194; State *v.* Hauser, 63 Ind. 155; Birdsall *v.* Clark, 73 N. Y. 73; Brooklyn *v.* Breslin, 57 N. Y. 591; Ruggles *v.* Collier, 43 Mo. 353.

[4] State, Hoxsey, *v.* Mayor & Aldermen of the City of Paterson, (1878) 40 N. J. Law, 186.

[5] Ibid. See reasoning of the court in Ramson *v.* Mayor, etc., of New York, 24 Barb. 226.

[6] Town of Mt. Vernon *v.* Patton, (1879) 94 Ill. 65.

from the action of a city council while acting as a board of equalization, this being the discharge of a corporate function, and acting as a representative of the city, a city solicitor would be justified in defending its action in the appellate court and for such services would be entitled to compensation, even though neither the service nor the compensation be provided for by ordinance.[1] An attorney employed by a town agent in Vermont in a suit in favor of or against the town is entitled to payment for his services from the town, without an express vote to that effect; and the rule is the same if the town agent, being an attorney, renders professional services for the town.[2] And if a town agent, after the expiration of his term of office, continues the management of suits in which the town is interested, without any objection from, or any express employment by the town or his successor, as town agent, he is entitled to recover of the town for his services after his term of office expires.[3] An officer of a city who has employed counsel in a contest to gain possession of the city's property, in the result of which the city is interested, may compel the city to pay the expenses incurred by him in the matter.[4]

§ 55. Employment of counsel for the defense of officers.—Counsel may be employed by a town to defend their police officers in actions for false imprisonment.[5]

[1] Kinnie *v.* City of Waverly, (1876) 42 Iowa, 437.

[2] Langdon *v.* Town of Castleton, (1858) 30 Vt. 285.

[3] Ibid.

[4] Stilwell *v.* Mayor, etc., of N. Y., 19 Abb. Pr. 376.

[5] Roper *v.* Town of Laurinburg, (1884) 90 N. C. 427; s. c., 7 Am. & Eng. Corp. Cas. 130; Babbitt *v.* Savoy, 3 Cush. 530. In Sherman *v.* Carr, 8 R. I. 431, an action of taxpayers to enjoin the payment by the treasurer to the mayor of moneys appropriated by the city council to defray the expenses of a suit brought against the mayor of a city and the constable who acted in his aid for certain acts of theirs in virtue of a power conferred upon the mayor by act of the general assembly of that state, BRADLEY, Ch. J., used this language in support of the judgment denying an injunction: "Is it then one of the usual and ordinary expenses of a city to protect its officers who, while exercising in good faith the functions of their office, have been found by the verdict of a jury to have exceeded the lawful powers of that office and to have trespassed upon the rights of a citizen? If the power to indemnify an officer under these circumstances does not rest in that body who appropriated the money for all the legitimate duties of a municipality within its own province, the various executive officers of a city perform their duties at the peril of an individual responsibility for all their mistakes of law and of fact, however honest and intelligent they may be, and also at the peril of the possible mistakes of a jury naturally jealous of the rights of the citizen when brought in conflict with the exercise of official power. If the officer is thus responsible he will naturally be too cautious, if not timid, in the exercise of his powers which must be frequently exercised for the protection of society, before and not after a thorough investigation of the case in which he is called upon to act. * * * We know of no case in which, while the officer continues to act in behalf of the community, and not in his own behalf, it is held that the community cannot indemnify him."

§ 56. Indemnity for expenses of litigation.—A promise on the part of a town to refund money paid by assessors on an illegal assessment of a town tax made by them is a valid contract.[1] An action by selectmen to recover the amount of a judgment for damages and costs recovered against them and paid, and the reasonable expenses of defending the action, paid and incurred by them, would be supported by a vote of the town to indemnify the selectmen against any claim for damages and costs of a certain description which may be legally substantiated against them or either of them.[2] And, on such a vote to indemnify them, the action may be to recover the amount of the judgment against the selectmen for the damages and costs and the fees of counsel and witnesses, and other expenses incurred reasonably and in good faith in defending the action in which the judgment was recovered without proving that the town had notice of the pendency of the action.[3] Money may be appropriated by a town by vote to indemnify its school committee for expenses incurred in defending an action for an alleged libel contained in a report made by them in good faith and in which libel suit judgment has been rendered in their favor.[4] A town, where it has appointed a committee to defend an action against one of its officers, as for instance, a surveyor of highways, on account of the digging of a drain, would be bound by a vote to defray the expenses incurred by such committee in his defense, notwithstanding it were under no previous obligation to indemnify the surveyor, and that the committee were entitled to compensation and indemnity from the town for their services and expenses.[5] A city may and should reimburse a mayor who has successfully resisted a proceeding

[1] Nelson *v.* Milford, (1828) 7 Pick. 18.

[2] Hadsell *v.* Inhabitants of Hancock, (1855) 3 Gray, 526.

[3] Ibid.

[4] Fuller *v.* Inhabitants of Groton, (1858) 11 Gray, 340.

[5] Bancroft *v.* Lynnfield, (1836) 18 Pick. 566.

taken in the name of the city against him to compel him to a course of official action deemed by him violative of law and detrimental to the city's interest, where the performance of that duty has involved on his part the disbursement of his own money.[1] Towns may bind themselves by a vote to indemnify a collector of taxes from the costs and expenses of defending actions brought against him for acts done in the performance of his duties. And the town may be bound to the same extent by the selectmen under the provision of the statute relating to towns that they "shall have the ordering and managing of all the prudential affairs of the town."[2]

§ 57. When a corporation is not bound for professional services of an attorney.— An attorney retained by a city to conduct certain litigation until it was concluded, upon an agreement that he was to receive reasonable compensation for his services, being afterwards appointed city counselor, with prescribed duties to perform in the matters of the city involving litigation, the Supreme Court of Michigan has held could not recover on a *quantum meruit* for services in such suit performed after his appointment to the official position, in the absence of any agreement that the business of carrying on the suit, though falling within his official duties, should not be considered as included among the services paid for by the annual salary, but should be compensated for in some other way.[3] A corporation cannot by a suit at law question its own existence, seek to restrain the regular succession of its officers, and to have a decree declaring its charter

[1] Barnert *v.* Mayor & Aldermen of City of Paterson, (1886) 48 N. J. Law, 395; s. c., 6 Atl. Rep. 15; 16 Am. & Eng. Corp. Cas. 131. On the right of a municipal corporation to reimburse its officers in such cases, see State, Lewis, *v.* Freeholders of Hudson, 37 N. J. Law, 254; State, Bradley, *v.* Hammonton, 38 N. J. Law, 430,

[2] Pike *v.* Middleton, (1841) 12 N. H. 278. As to indemnity for expenses in suits in which the town is interested, see Baker *v.* Inhabitants of Windham, (1836) 13 Me. 74. Towns may by a vote bond themselves for expenses of a suit when action is for or against them, and in cases even where the suit is between third parties, if the towns are interested. Briggs *v.* Whipple, (1834) 6 Vt. 95. In Cullen *v.* Town of Carthage, (1885) 103 Ind. 196; s. c., 53 Am. Rep. 504; 14 Am. & Eng. Corp. Cas. 256, the court upheld the power, as an incidental one, of the board of trustees of a town to employ counsel to defend the action brought against the marshal of the town for false imprisonment by one whom he had arrested for violation of law.

[3] City of Detroit *v.* Whittemore, (1873) 27 Mich. 281.

void, and having no power to institute such a suit, its authorities cannot bind it to pay for the services of an attorney in the conduct of the suit.[1] The statute of Arkansas makes provision for an allowance by the County Court in favor of a collector of taxes for reasonable attorneys' fees and other expenses incurred in defending suits brought against him for performing or attempting to perform any duty in reference to the collection of the revenue.[2] But a county is not bound to pay attorneys he may be represented by in an action for injunction against his collection of a tax, under a contract with the collector. He has no power to bind the county to pay such fees. And, in the absence of statutory regulation, he alone is liable in such cases.[3]

§ 58. The same subject continued.— A board of county commissioners in Indiana is authorized to employ counsel in matters pertaining to the business of the county, and to give to the members of the board legal advice in relation to their official duties; but they have no power to bind their successors by employing attorneys to act for a period beyond the time when the board will, by operation of law, have to be reorganized.[4] A county is not bound by the expenses for attorney's services incurred by a county collector for resisting objections to his bond.[5] Negotiable drafts drawn by a municipal corporation for

[1] Daniel *v.* Mayor & Aldermen of Memphis, (1851) 11 Humph. 582. In Wallace *v.* Mayor & Common Council of the City of San Jose, (1865) 29 Cal. 180, it was held that there was no power, under the charter of this city, in the mayor and council to enter into a contract by which the city became obligated to pay an attorney at a future time a sum of money, if he succeeded in placing the city in possession of certain real estate, unless there was money in the treasury at the time to pay the same, after paying the expenses of the city government and all other demands legally due. As to this contract creating a debt, see People *v.* Johnson, 6 Cal. 499; Nougues *v.* Douglass, 7 Cal. 65, 69; People ex rel. McCullough *v.* Pacheco, 27 Cal. 175.

[2] Mansf. Dig. Ark. § 5859.

[3] Simmes *v.* Chicot County, (1888) 50 Ark. 566; s. c., 9 S. W. Rep. 308; Fry *v.* Chicot Co., 37 Ark. 117.

[4] Board of Comrs. of Jay County *v.* Taylor, (1889) 123 Ind. 148; s. c., 23 N. E. Rep. 752; 30 Am. & Eng. Corp. Cas. 294.

[5] Fry, Collector, *v.* Chicot County, (1881) 37 Ark. 117. In Baldwin *v.* School City of Logansport, (1881) 73 Ind. 346, where the school trustees of the city made an order authorizing the treasurer of the school board to employ attorneys "to prosecute the county auditor for refusing to pay over moneys belonging to the school fund, and shortly afterward there was elected a new board of school trustees, whereupon the attorneys employed under the order of the former trustees proceeded in the proper court for a

the payment of judgments and costs in actions brought against the supervisors of the county for penalties for an alleged neglect of duty in refusing to audit and allow salaries to associate judges of general sessions of the corporation appointed under an unconstitutional law, have been held in New York to be void upon the ground that the corporation had no right to assume defense of an action to which it was not a party and which it had no interest in resisting.[1]

§ 59. What contracts with attorneys are contrary to public policy.—A contract entered into by the authorities of a city, with an attorney who had been under the employment of the city in a litigation to protect its rights in certain property and franchises, under a former contract, which by its terms is irrevocable and binds the city for additional compensation to such attorney in the form of a large proportion of the city's receipts, as, for instance, from the use of a ferry by the public, is beyond the power of such authorities; is contrary to public policy.[2]

§ 60. Limitations upon the indebtedness to be incurred.—By a statute of Massachusetts one of its cities, for the purpose of supplying pure water to its citizens, after providing for condemnation of lands, etc., and the appointment of commissioners to execute the work, was authorized through its city council "for the purpose of defraying the cost" of whatever lands were so

mandate to the auditor, etc., the object of the suit being to determine who were the legal school trustees, it was held that the order of the school trustees above mentioned did not authorize the employment of the attorneys to bring a civil suit to try the question as to who were the legal trustees, and the school city was not liable for the fees of the attorneys for such services.

[1] Halstead *v.* Mayor, etc., of New York, 3 N. Y. 430, affg. 5 Barb. 218.

[2] Waterbury *v.* City of Laredo, (1887) 68 Tex. 565; s. c., 20 Am. & Eng. Corp. Cas. 186. It was said by the court: "Such a contract, if valid, certainly would divest the municipal government of the discretion conferred upon it — a discretion necessarily legislative in character, which such a body cannot surrender by contract or bind itself not to exercise freely whenever it may become necessary." Waterbury *v.* City of Laredo, 60 Tex. 522; Laredo *v.* Macdonnell, 52 Tex. 520; Laredo *v.* Martin, 52 Tex. 559. In Board of Comrs. of Jay County *v.* Taylor, (1889) 123 Ind. 148; s. c., 23 N. E. Rep. 752; 30 Am. & Eng. Corp. Cas. 294, a contract entered into between the board of commissioners and certain attorneys, by which the board employed these attorneys to act as county attorneys for a period of three years from a date named in the contract, was held to be void as contrary to public policy.

condemned, and of completing the works and paying all expenses incident to the accomplishment of the main purpose "to issue scrip to an amount not exceeding in the whole five hundred thousand dollars." The Supreme Court of Judicature of that state construed this act not to restrict the city in the amount of expenditures which they might make for the accomplishment of the purpose of the act, but only in the amount of permanent debt which they might create.[1] The provision in the charter of a city that the council "shall not borrow for general purposes more than fifty thousand dollars," the Supreme Court of the United States has held did not limit the debt of the city, nor prohibit the council from entering into a contract involving an expenditure exceeding that amount for special improvements, such as the grading and paving of streets and the construction of sidewalks, which were authorized by its charter.[2] The effect of

[1] Foote *v.* City of Salem, (1867) 14 Allen, 87. Bigelow, Ch. J., said: "It is a restriction on the authority of the city to create a permanent debt, payable at a distant period of time, but not a limitation on their powers to raise money by taxation or temporary loans in order to carry forward and execute the works which, by the previous provisions of the act, they were in the broadest terms empowered to construct. * * * If construed as an absolute condition or limitation on the authority of the city, no steps could be safely taken to execute the authority conferred, unless it had been previously ascertained that the expenditure to be incurred would not exceed the prescribed sum. But it is obvious that this would be clearly impracticable in relation to an enterprise of the character contemplated by the statute."

[2] Hitchcock *v.* Galveston, (1877) 96 U. S. 341, holding further that the contract was not rendered wholly inoperative because it provided that the work done under the contract should be paid for in bonds of the corporation, the issue of which bonds was unauthorized by law. The contract, so far as it was in other respects lawful, remained in force, and for the breach of the same the corporation was liable. See as to this last point: Tracy *v.* Talmage, 14 N. Y. 162; Curtis *v.* Leavitt, 15 N. Y. 9; Oneida Bank *v.* Ontario Bank, 21 N. Y. 490; Argenti *v.* City of San Francisco, 16 Cal. 255; Maher *v.* City of Chicago, 38 Ill. 266; City of Chicago *v.* The People, 48 Ill. 416. In The State Board of Agriculture *v.* Citizens' Street Railway Co., 47 Ind. 407, it was held that although there may be a defect of power in a corporation to make a contract, yet if a contract made by it is not in violation of its charter or of any statute prohibiting it, and the corporation has by its promise induced a party relying on the promise and in execution of the contract to expend money and perform his part thereof, the corporation is liable on the contract. See, substantially to the same effect, Allegheny City *v.* McClurkan, 14 Penn. St. 81; Silver Lake Bank *v.* North, 4 Johns. Ch. 370. As to the rule in the text, see Cumming *v.* Brooklyn, 11 Paige, 596; Allen *v.* City of Janesville, 35 Wis. 403; Argenti *v.* City of San Francisco, 16 Cal. 255.

charter provisions of a city prohibiting the creation of municipal liabilities in any one year exceeding the amount to be raised by tax and providing that payments on a municipal contract shall be made from sums raised by tax for the year for which such contract is made, is to forbid the creation of future responsibility for annual current expenses.[1] The provisions in the statute of Iowa declare that it is competent for any city authorized by that statute to levy a tax to pay for the paving of street and alley intersections "to anticipate the collection thereof by borrowing money, and pledging such tax, whether levied or not, for the payment of the money so borrowed." The Supreme Court of that state has held that there was no limitation upon the city as to the amount of the work of the kind contemplated it might do in a single year except the limitation in the Constitution as to the indebtedness it might contract, and that the provision above referred to did not limit the city in making the loan provided for to the amount of tax which would accrue under a levy for a single year, but that it was empowered to pledge the tax to any extent necessary to enable it to meet such indebtedness as it might lawfully incur in a single year, and to levy a tax for successive years for that purpose.[2]

§ 61. The same subject continued.— The indebtedness of a school district having exceeded that allowed by the constitutional limitation, should its directors contract an indebtedness with other

[1] Putnam *v.* City of Grand Rapids, (1885) 58 Mich. 416; s. c., 25 N. W. Rep. 330; City of Springfield *v.* Edwards, 84 Ill. 626; Law *v.* People, 87 Ill. 385; Fuller *v.* City of Chicago, 89 Ill. 282; Howell *v.* City of Peoria, 90 Ill. 104; New Orleans *v.* Clark, 95 U. S. 644, 652; French *v.* City of Burlington, 42 Iowa, 614; National State Bank *v.* Independent District, 39 Iowa, 490; McPherson *v.* Foster, 43 Iowa, 48; City of Council Bluffs *v.* Stewart, 51 Iowa, 385; Scott *v.* City of Davenport, 34 Iowa, 208; Mosher *v.* Independent School District, 44 Iowa, 122; East St. Louis *v.* People, 6 Bradw. 76; Buchanan *v.* Litchfield, 102 U. S. 278.

[2] Coggeshall *v.* City of Des Moines, (1889) 78 Iowa, 235; s. c., 41 N. W. Rep. 617; 42 N. W. Rep. 650. A contract entered into by a city with a water works company to furnish water to the city for an annual sum has been held not to be in violation of a law that the council of the city shall contract no debt on its part which shall not be payable within the fiscal year in which it was contracted, and which cannot be discharged from the income of such year, as the compensation for each year's service of the company under the contract in question was payable in that year and each year's indebtedness was only for the water furnished in that year. Utica Water Works Co. *v.* City of Utica, (1884) 31 Hun, 426.

persons, and afterwards, through collusion with those other persons, permit them to obtain judgment for such indebtedness against the school district, the judgment would be of no validity against the district, and could not be enforced.[1] The limitation of the indebtedness which may be incurred by a county of the territory of Utah, as fixed by the act of congress with reference to territories and the territorial legislature, is the amount of the income and revenue of the county for the two years just preceding the incurring of the indebtedness, and the Supreme Court of the territory has held county warrants, issued for indebtedness beyond that amount, to be void and unauthorized.[2]

[1] Kane *v.* Independent School Dist. of Rock Rapids, (1891), 82 Iowa, 5; s. c., 47 N. W. Rep. 1076.

[2] Fenton *v.* Blair, (Utah, 1895) 39 Pac. Rep. 485. In Butts *v.* Little, (1881) 68 Ga. 272, the Supreme Court of Georgia held that for a county to contract for the erection of a public building at a specified price, which was to be completed by a certain date, and payment for which was to be made as the work progressed, on estimates to be made by certain architects, less fifteen per cent, was in effect a contract to pay the price agreed on by the day of the date of completion fixed; and the amount being more than could constitutionally be raised by taxation without authority of the voters exhibited by an election, was to incur a debt not authorized by the Constitution. See Spann *v.* Webster County, 64 Ga. 498, 500; Hudson *v.* Marietta, 64 Ga. 286. As to the effect of limitation upon the power to create indebtedness, see Murphy *v.* East Portland, 42 Fed. Rep. 308; Lott *v.* Mayor, etc., of City of Waycross, 84 Ga. 681; s. c., 11 S. E. Rep. 558; Dehm v. City of Havana, 28 Ill. App. 520; Clark *v.* Columbus, 23 Wkly. Law Bull. 289; Coggeshall v. City of Des Moines, 78 Iowa, 235; s. c., 41 N. W. Rep. 617. In Cabaniss *v.* Hill, (1885) 74 Ga. 845, a contract for certain iron doors, cells, pipes for sewers, etc., furnished a county under a contract which provided that the contractors agreed "to take and receipt the sum of $3,510 in warrants on county treasurer, payable on December 25, 1884, and bearing eight per cent interest after that date until paid in full, in payment for said cells and wrought iron works," for which, at the November term of the Court of Ordinary orders were issued to "pay out of any money now being collected for new jail fund," was held to create a new debt, and that it was in violation of the Constitution of the state. Rogers *v.* Board of Comrs. Le Sueur County, (Minn.) 59 N. W. Rep. 488; Hunt *v.* Fawcett, 8 Wash. 396; s. c., 36 Pac. Rep. 318; Hockaday v. Comrs., 1 Colo. App. 362; Barnard *v.* Knox County, 105 Mo. 382; s. c., 16 S. W. Rep. 917, overruling Potter *v.* Douglas Co., 87 Mo. 240; Bonnell *v.* County of Nuckolls, 32 Neb. 189; s. c., 49 N. W. Rep. 225, affirming Bonnell *v.* Nuckolls County, 28 Neb. 90; s. c., 43 N. W. Rep. 1145; Baird *v.* Todd, 27 Neb. 782; Spilman *v.* City of Parkersburg, 35 W. Va. 605; s. c., 14 S. E. Rep. 279; Hockaday *v.* Board of County Comrs., (Colo. App.) 29 Pac. Rep. 287; Nolan County *v.* State, 83 Tex. 182; s. c., 17 S. W. Rep. 823; People *v.* Hamill, 134 Ill. 666; s. c., 29 N. E. Rep. 280; Rehmke *v.* Goodwin, 2 Wash. St. 676; s. c., 27

§ 62. Limitations upon power to incur indebtedness — procuring a supply of water.—Where the common council of a city was prohibited by the charter from contracting debts or incurring liabilities exceeding in any one year the revenue for such year unless authorized by a majority vote of the electors of the city, the Supreme Court of Michigan held that a contract made by the common council without such a vote for the use of at least fifty water hydrants per year at fifty dollars each for a term of thirty years, created a liability against the city to the full extent of the thirty years' rental, which aggregate liability being in excess of the revenue which could be legally raised in any one year, the contract was void.[1]

Pac. Rep. 473; Mayor, etc., of Rome *v.* McWilliams, (1881) 67 Ga. 106; State ex rel. Vandiver *v.* Tolly, (S. C., 1892) 16 S. E. Rep. 195; Childs *v.* City of Anacortes, (1892) 5 Wash. St. 452; s. c., 32 Pac. Rep. 217.

[1] Niles Water Works *v.* Mayor, etc., of the City of Niles, (1886) 59 Mich. 311; s. c., 26 N. W. Rep. 525; 11 Am. & Eng. Corp. Cas. 299. In Davenport *v.* Kleinschmidt, (1887) 6 Mont. 502; s. c., 16 Am. & Eng. Corp. Cas. 301, where the bonded indebtedness of a city was $19,500 and the floating indebtedness over $15,000, a contract bonding the city to take water from a contractor at an annual rent of $15,000 was held to be in violation of a provision in the charter of the city limiting the power of the city council "to incur any indebtedness on behalf of said city for any purpose whatever to exceed the sum of $20,000, as such contract created an indebtedness within the meaning of this limitation. See on this subject Burlington Water Co. *v.* Woodward, 49 Iowa, 58, 61; Grant *v.* City of Davenport, 36 Iowa, 396, 401; Sackett *v.* City New Albany, 88 Ind. 473; s. c., 45 Am. Rep. 472; Prince *v.* City of Quincy, 105 Ill. 138, 142; State *v.* Mayor, 23 La. Ann. 358; Smith *v.* Inhabitants of Dedham, (1887) 144 Mass. 177; s. c., 10 N. E. Rep. 782. That towns having power to provide for the purchase and maintenance of fire engines for the extinguishment of fires have the incidental power to make provision, by reservoirs or other means, for a supply of water, without which the engines would be useless, see Hardy *v.* Waltham, 3 Met. 163. In Salem Water Co. *v.* City of Salem, 5 Oreg. 30, it was held that an agreement by the city to pay the water company $1,800 per annum for seventeen years in quarterly installments for water to be furnished the city without any provision for raising and appropriating revenue to be applied in payment for such liabilities as they became due, necessarily created a liability within the meaning of the act of incorporation of the city which prohibited the city from creating "any debt or liabilities in any manner" against the city which should exceed the sum of $1,000; and that the contract was void. The court reviewed the following cases pertinent to this ruling: State of California *v.* McCauley, 15 Cal. 429; People ex rel. McCauley *v.* Brooks, 16 Cal. 11, 24; Koppikus *v.* State Capitol Commissioners, 16 Cal. 249, 253; State *v.* Medbery, 7 Ohio St. 526; People *v.* Pacheco, 27 Cal. 175; Coulson *v.* City of Portland, 1 Deady, 481.

§ 63. The same subject continued.—Power conferred upon cities by statute "to construct, maintain and operate water works" does not, expressly or impliedly, deprive such cities of their pre-existing and co-existing power and right to "authorize any incorporated company or association to construct such works" for furnishing the city with wholesome water.[1] The Indiana Supreme Court, in a later case involving a contract with a water company, has held that although the power of a city to contract for a supply of water for public use, be, in a general sense, a discretionary one, it cannot be so exercised as to create a corporate debt beyond that limited by law, nor to surrender or suspend legislative power.[2] A city vested by the terms of its charter with "full power and authority to make such assessments on the inhabitants of the city, or those who hold taxable property therein, for the safety, benefit, convenience and advantage of said city, as shall appear to them expedient" may make an assessment

[1] City of Vincennes *v.* Callender, (1882) 86 Ind. 484, sustaining a contract of the city with a water company to supply water as not *ultra vires*.

[2] City of Valparaiso *v.* Gardner, (1884) 97 Ind. 1. As to the contract in this case, it was generally said by ELLIOTT, Ch. J.: "We have no doubt that the corporation had authority to contract for a supply of water for a period of twenty years, and that the contract cannot be overthrown solely on the ground that it is a surrender of legislative power. There is a distinction between powers of a legislative character and powers of a business nature. The power to execute a contract for goods, for houses, for gas, for water and the like, is neither a judicial nor a legislative power, but is a purely business power. The question is, however, so firmly settled by authority that we deem it unnecessary to further discuss it. City of Indianapolis *v.* Indianapolis, etc., Co., 66 Ind. 396; Dill. on Mun. Corp. §§ 473, 474, and authorities cited." Upon the question of the restriction upon the city stated in the text and as to what constitutes a "debt" or "indebtedness," under the constitutional provisions of various states, the Indiana court refer to and comment upon the following cases: Sackett *v.* City of New Albany, 88 Ind. 473; Lowber *v.* Mayor, etc., 5 Abb. Pr. 325; Clarke *v.* City of Rochester, 24 Barb. 446; Weston *v.* City of Syracuse, 17 N. Y. 110; Garrison *v.* Howe, 17 N. Y. 458; Wentworth *v.* Whittemore, 1 Mass. 471; People *v.* Arguello, 37 Cal. 524; East St. Louis *v.* East St. Louis, etc., 98 Ill. 415; Prince *v.* City of Quincy, 105 Ill. 138; s. c., 44 Am. Rep. 785; Dively *v.* City of Cedar Falls, 27 Iowa, 227. Approved of in 1 Dill. on Mun. Corp. (3d ed.) § 135; Grant *v.* City of Davenport, 36 Iowa, 396; French *v.* City of Burlington, 42 Iowa, 614; Burlington Water Co. *v.* Woodward, 49 Iowa, 58; Scott County *v.* City of Davenport, 34 Iowa, 208; State *v.* McCauley, 15 Cal. 429; People *v.* Pacheco, 27 Cal. 175; Coulson *v.* City of Portland, Deady, 481; Coy *v.* City Council, 17 Iowa, 1; Coffin *v.* City Council, 26 Iowa, 515.

on the value of the real estate within the corporate limits of the city, through its city council, for the purpose of constructing a canal for the better securing a supply of water for the city.[1] A municipal corporation may under legislative grant of power, to make all contracts in its corporate capacity which may be deemed necessary for the welfare of the corporation, make a contract for the construction of water works.[2] Under the statute entitled "An act to enable cities to supply the inhabitants thereof with pure and wholesome water,"[3] a city is authorized to contract for a supply of water for public and private use.[4]

§ 64. Donation of bonds to aid in developing water power. — A municipal corporation, the charter of which authorizes it "to borrow money on the credit of the city and to issue bonds therefor," and which, under a special statute, is authorized to borrow a sum named "to be expended in developing the natural advantages of the city for manufacturing purposes," has no authority, under the grants of power above stated, to issue bonds by way of donation to an individual to aid in developing the water power of the city, and is not liable to an action upon such bonds by one who takes them with notice of the facts.[5]

[1] Frederick *v.* City Council of Augusta, (1848) 5 Ga. 561. This canal was constructed for procuring a better supply of water and for manufacturing purposes.

[2] Mayor & Council of Rome *v.* Cabot, (1859) 28 Ga. 50.

[3] Pub. Laws N. J. (1876), 366.

[4] Hackensack Water Co. *v.* City of Hoboken, 51 N. J. Law, 220; s. c., 17 Atl. Rep. 307. As to contracting for water supply, see City of Grand Rapids *v.* Hydraulic Co., 66 Mich. 606; s. c., 33 N. W. Rep. 749; Adrian Water Works *v.* City of Adrian, 64 Mich. 584; s. c., 31 N. W. Rep. 529; Culbertson *v.* City of Fulton, 127 Ill. 30; s. c., 18 N. E. Rep. 781; Atlantic City Water Works Co. *v.* Read, 50 N. J. Law, 665; s. c., 15 Atl. Rep. 10.

[5] Ottawa *v.* Carey, (1883) 108 U. S. 110; s. c., 2 Sup. Ct. Rep. 361. The court distinguished Hackett *v.* Ottawa, 99 U. S. 86, and Ottawa *v.* National Bank of Portsmouth, 105 U. S. 342, involving bonds of the same issue, where it was held in substance that, as there was legislative authority to issue bonds for municipal purposes, and it was recited in the bonds then sued on that they were issued for such purposes, the city was estopped from proving, as against *bona fide* holders, that the recitals were untrue; and as the plaintiffs in those cases had no knowledge of the precise purposes for which the bonds were issued, they had the right to rely on what was recited. The parties here suing did know the purpose for which they were issued. These bonds being Illinois contracts, WAITE, Ch. J., referred to these cases: Taylor *v.* Thompson, 42 Ill. 9; Chicago, Danville & Vincennes R. R. Co. *v.* Smith, 62 Ill. 268; The People *v.* Dupuyt, 71 Ill. 651; Burr *v.* City of Carbondale, 76 Ill. 455; People *v.* Trustees of Schools, 78 Ill. 136; Quincy, Missouri & Pacific R. R. Co. *v.* Morris, 84 Ill. 410; Supervisor, etc., of Hensley Township *v.* The People, 84 Ill. 644, as to what might be held to be a corporate purpose. The chief justice then used this language as to the case before the court: "As power in a municipal corporation to borrow money and issue bonds therefor implies power to levy a tax for the payment of the obligation that is incurred, unless the contrary clearly appears (Ralls County Court *v.* The United States, 105 U. S. 733), it follows that the power contained in the charter to borrow money did not authorize the issue of the bonds in this case, unless they were issued for a corporate purpose, there being a constitutional prohibition against taxation by the city, except for corporate purposes. * * * The charter confers all the powers usually granted for the purposes of local government, but that has never been supposed of itself to authorize taxes for every thing which, in the opinion of the city authorities, would 'promote the general prosperity and welfare of the municipality.' Undoubtedly the developments of the water power in the rivers that traverse the city would add to the commerce and wealth of the citizens, but certainly power to govern the city does not imply power to expend the public money to make the water in this river available for manufacturing purposes. It is because railroads are supposed to add to the general prosperity that municipalities are given power to aid in their construction by subscriptions to capital stock or donations to the corporations engaged in their construction; but in all the vast number of cases involving subscriptions and donations that have come before this court for adjudication since The Commissioners of Knox County *v.* Aspinwall, decided twenty-five years ago and reported in 21 How. 539, it has never been supposed that the power to govern, of itself, implied power to make such subscriptions or such donations. On the contrary, it has been over and over again held, and as often as the question was presented, that unless the specific power was granted, all such subscriptions and all such donations, as well as the corporation bonds issued for their payment, were absolutely void, even as against *bona fide* holders of the bonds. Thomson *v.* Lee County, 3 Wall. 327; Marsh *v.* Fulton County, 10 Wall. 676; St. Joseph Township *v.* Rogers, 16 Wall. 644; McClure *v.* Township of Oxford, 94 U. S. 429; Wells *v.* Supervisors, 102 U. S. 625; Allen *v.* Louisiana, 103 U. S. 80."

CHAPTER II.

GENERAL POWER TO INCUR PECUNIARY LIABILITY — PRIVATE CORPORATIONS.

§ 65. General rules as to incurring indebtedness.
66. Purchase of property.
67. Aiding other corporations.
68. Contracts of suretyship.
69. Guaranty of bonds of one railway corporation by another.
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83. Raising money by borrowing notes and indorsement of them.
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88. Limitation of indebtedness.
89. Debt limited by par value of capital stock.
90. When a statutory limitation of indebtedness does not apply.

§ 65. General rules as to incurring indebtedness.— Within the scope of its general and discretionary powers, the authority of a corporation to dispose of its funds for any purpose whatever may be admitted to be absolute and beyond all control.[1] It is always presumed that a corporate body may make any proper contracts, the scope and tendency of which are manifestly to forward the design of its legislative creation.[2] Such corporations, if not restricted by their charters, have incidental authority to borrow money for any of their lawful purposes.[3] But the power to borrow money, being an incidental power, does not extend

[1] Binney's Case, (1829) 2 Bland's Ch. 99, 142.

[2] Kitchen *v.* Cape Girardeau & State Line R. R. Co., (1876) 59 Mo. 514, an action to recover for services as an agent under employment to perform services consonant to the general design of the corporation.

[3] Partridge *v.* Badger, 25 Barb. 146.

beyond cases where it is essential to the transaction of its ordinary affairs.[1] The limit fixed in the charter of a corporation as to its capital does not restrict its power to contract debts for the purpose of the incorporation as to their amount, nor as to the amount of property it may purchase or accumulate.[2] A private corporation has been held liable, at least to the extent of the consideration received, for indebtedness assumed to be contracted in excess of the limit imposed by the articles of incorporation.[3] A corporation, created with authority to construct a certain road and collect toll thereon, may purchase a like road already constructed, and charge toll thereon.[4] A corporation organized under a state corporation act which authorizes the formation of a corporation to engage "in any lawful enterprise, business, pursuit or occupation," has power to buy and sell or lease a railway.[5] There is an implied power in a corporation empowered to construct a work to borrow money necessary for the purpose of such construction, and to issue its bonds for the money borrowed.[6] A corporation authorized by the general law under which it is incorporated to borrow money for the purpose of constructing its works, and to issue bonds for its payment, has the power to purchase works already constructed and suitable for its purposes, and issue bonds in payment for such works.[7] In such a case, the corporation may issue stock for a portion of the purchase money of such works, and pay in cash or issue bonds for the balance.[8]

[1] Beers *v.* Phœnix Glass Co., 14 Barb. 358.

[2] Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280.

[3] Humphrey *v.* Patrons' Mercantile Association, (1879) 50 Iowa, 607. The New York Court of Appeals has sustained the validity of a contract of a private corporation for proper and necessary work preliminary to active business operations, as within its incidental power to make any contract necessary to advance the object for which it was created. Legrand *v.* Manhattan Mercantile Association, (1880) 80 N. Y. 638, affirming 44 N. Y. Super. Ct. 562. See Broughton *v.* M. Water Works, 3 B. & A. 1; Bank of Columbia *v.* Patterson, 7 Cranch, 299; Straus & Bro. *v.* Eagle Ins. Co. of Cincinnati, 5 Ohio St. 59.

[4] State ex rel. *v.* Hannibal, etc., Road Co., (1889) 37 Mo. App. 496.

[5] Oregonian Ry. Co. *v.* Oregon Ry. & Navigation Co., 23 Fed. Rep. 232.

[6] Smith *v.* Law, 21 N. Y. 296.

[7] Gamble *v.* Queens County Water Co., (1890) 25 Abb. N. C. 410, reversing 52 Hun, 166.

[8] Ibid. As to legislature's power to authorize corporations of its creation to borrow money, etc., see Covington *v.* C., etc., Bridge Co., (1873) 10 Bush, 74. As to power to borrow money, see Union M. Co. *v.* Rocky Mt. Nat. Bank, 2 Col. 248; Beers *v.* Phœnix Glass Co., 14 Barb. 358; Mead *v.* Keeler, 24 Barb. 20. As to raising

A corporation, with power to borrow money, may legitimately borrow promissory notes upon which to raise money for its business.[1]

§ 66. Purchase of property.— By the common law corporations have a right to purchase and hold property so far as may be necessary to carry into execution the purposes and objects for which they are created.[2] A corporation incorporated under the general laws of Alabama, has power to borrow money to purchase and improve real estate that it may be enabled to carry into effect the purposes of its incorporation.[3] The Iowa Supreme Court has held that a corporation authorized by its charter to purchase, etc., "any real estate or other property *deemed* advisable in the transaction of its business" might purchase its own

money for the purpose of carrying out the purposes of its creation, see Wellersburg, etc., Co. *v.* Young, 12 Md. 476; Mayor, etc., of Baltimore *v.* Baltimore & Ohio R. R. Co., 21 Md. 91. As to the means employed to carry out such purposes, coming within the implied powers of corporations, see Willmarth *v.* Crawford, 10 Wend. 342; Madison, etc., Plank Road Co. *v.* Watertown, etc., Plank Road Co., 5 Wis. 173; Clark *v.* Farrington, 11 Wis. 306. As to these implied powers being performed by their agents, see Smith *v.* Eureka Flour Mills, 6 Cal. 1; Straus & Bro. *v.* Eagle Ins. Co., 5 Ohio St. 59. As to making promissory notes under the implied power, see Moss *v.* Oakley, 2 Hill, 265; Munn *v.* Commission Co., 15 Johns. 44; Mott *v.* Hicks, 1 Cow. 513; Auerbach *v.* Le Sueur Mill Co., (1881) 28 Minn. 291; s. c., 9 N. W. Rep. 799; Sullivan *v.* Murphy, 23 Minn. 6; Chaska Company *v.* Board of Supervisors of Carver Co., 6 Minn. 204.

[1] Holbrook *v.* Basset, 5 Bosw. 147.

[2] Blanchard's Gun-Stock Turning Factory *v.* Warner, (1848) 1 Blatchf. 258.

[3] Alabama Gold Life Ins. Co. *v.* Central Agricultural & Mechanical Association, (1875) 54 Ala. 73. *Arguendo* it was said by BRICKELL, Ch. J: "The general principle is that a corporation can make no contracts, and do no acts, except such as are authorized by its charter. From the charter it derives all its powers, and the capacity of exercising them. Any contract made by it not necessary and proper, directly or indirectly, to enable it to answer the purpose of its creation, is void, and neither a court of law or of equity can enforce it. Grand Lodge *v.* Waddill, 36 Ala. 313; Smith *v.* Ala. Life Ins. & Trust Co., 4 Ala. 558; City Council *v.* Montgomery & Wetumpka Plank Road, 31 Ala. 76. It must not be understood, however, that the charter, whether it is of special legislative enactment, or derived from general statutory provisions, must expressly confer the power of making contracts. As we have said, the capacity to contract is an incidental corporate power, and if the special act of incorporation, or the general statutory law is silent as to the contracts into which a corporation may enter, it has the power to make all such contracts as are necessary and proper to enable it to accomplish the purposes of its creation. Ang. & Ames on Corp.

stock.[1] Upon evidence that it was customary and necessary, in the economical conduct of the business of iron furnaces to conduct a supply store in connection therewith, the Supreme Court of Tennessee has held that debts created in the purchase of a stock of goods for such store were valid obligations of the furnace company. The power to conduct such a store being clearly inci-

§ 271. This is the theory on which the general statutes for the organization of private corporations proceed, for though the powers of such corporation are enumerated, that of making contracts is not included, but is left to implication from the powers mentioned, and the character and purposes of the corporation. It is not indispensable, therefore, to the validity of a contract made by a corporation for money borrowed, that the power to borrow money should be expressly conferred. Ang. & Ames on Corp. § 257. If the nature and character of the corporation render the power a usual and proper mode of accomplishing its objects and purposes, the power is incidental or implied. When the corporation has, as all private corporations have, under the general law providing for their creation, the capacity of acquiring and holding personal and real property, the mode of acquiring not being limited, they may acquire it by purchase or by gift. The corporation has the capacity of an individual in this respect, within the scope of its legitimate objects and purposes. Having the power to acquire and hold personal and real estate by purchase, it has, as an incident, the power to borrow money to make the purchase. The exercise of such power may be advantageous and useful, enabling the corporation, the owner, to put its powers into active exercise, and to acquire the necessary property on terms more profitable to its stockholders. It would scarcely be affirmed that the power to acquire and hold real and personal estate must be so narrowed that the corporation could not contract a debt for its purchase — that at the very moment of the purchase and conveyance the purchase money must be counted out or the purchase and conveyance is void. If the necessities and interests of the corporation require it, which must be determined by those having charge of its affairs, and intrusted with the power and duty, that a debt be contracted in the acquisition of the necessary property, the power to contract it cannot be denied. If more advantageous to borrow the money and make immediate payment than to contract the debt for the purchase money with the vendor, the contract is equally within the scope of corporate power and valid." Fay *v.* Noble, 12 Cush. 1; Davis *v.* Proprietors of Meeting House, 8 Met. 321; Union Bank *v.* Jacobs, 6 Humph. 515; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280; Burr *v.* McDonald, 3 Gratt. 215; Curtis *v.* Leavitt, 15 N. Y. 9; Bradley *v.* Ballard, (1870) 55 Ill. 413; Mead *v.* Keeler, (1857) 24 Barb. 20; Partridge *v.* Badger, (1857) 25 Barb. 146; Clark *v.* Titcomb, (1864) 42 Barb. 122; Life & Fire Ins. Co. *v.* Mechanic Fire Ins. Co., (1831) 7 Wend. 31; Barnes *v.* Ontario Bank, (1859) 19 N. Y. 152; Smith *v.* Law, (1860) 21 N. Y. 296; Ridgway *v.* Farmers' Bank of Bucks Co., (1825) 12 Serg. & R. 256; Hamilton *v.* Newcastle & Danville R. R. Co., (1857) 9 Ind. 359; Rockwell *v.* Elkhorn Bank, (1861) 13 Wis. 653.

[1] Iowa Lumber Co. *v.* Foster, (1878) 49 Iowa, 25. As supporting this doctrine, see Barton *v.* P. J. & U. F.

dental to the business of making iron, was, therefore, within the corporate powers of the company, though not mentioned in the charter.[1]

§ 67. Aiding other corporations.— An act of the legislature of New York authorizing the several railroad corporations of that state to subscribe to the capital stock of a railroad company designed to penetrate the western country has been held to be constitutional and valid.[2] The Supreme Court of Nevada has held a contract by a mining corporation to advance a specific sum of money to aid in the construction of a tunnel to drain its mine not to be *ultra vires*, and that such a contract came within the incidental and implied powers of a mining company.[3] Notwithstanding the Code of Oregon in one place provides that "persons" shall be construed to include a corporation, the authority granted under the same Code to two or more "persons" to form a corporation in a certain manner does not empower a corporation to become a subscriber to shares in another corporation.[4] The Court of Appeals of Maryland has sustained the power of one steamboat company to purchase shares of stock in another.[5] A

Plank Road Co., 17 Barb. 397; Cooper *v.* Frederick, 9 Ala. 738; Verplanck *v.* Mer. Ins. Co., 1 Edw. Ch. 84; Hartridge *v.* Rockwell, R. M. Charlton, 260; Gillet *v.* Moody, 3 Comst. 479; Taylor *v.* Miami Exporting Co., 6 Ohio, 176; State Bank *v.* Fox, 3 Blatchf. 431; City Bank of Columbus *v.* Bruce, 17 N. Y. 507.

[1] Searight *v.* Payne, 6 Lea, 283.

[2] White *v.* Syracuse & Utica R. R. Co., (1853) 14 Barb. 559.

[3] Sutro Tunnel Co. *v.* Segregated Belcher Mining Co., 19 Nev. 121; s. c., 7 Pac. Rep. 271.

[4] Denny Hotel Co. of Seattle *v.* Schram, (Wash.) 32 Pac. Rep. 1002.

[5] Booth *v.* Robinson, (1880) 55 Md. 419. It was said by the court: "This [purchase and holding of this stock], it is contended, by the plaintiffs, could not be done without express authority by law. But, while some courts have so held, the great weight of authority is the other way. There is nothing in the charter of the steam packet company or in the nature of its business that would, in the slightest manner, forbid the exercise of such power, and having money to loan or invest, there would appear to be no good reason why it might not invest in the stock of other corporations as well as in any other funds, provided it be done *bona fide* and with no sinister or unlawful purpose. The courts of England at one time strongly opposed the rights of one corporation to deal or invest in the stock of another corporation without express authority for so doing, but that opposition has been entirely overcome and it is now settled there that one corporation may deal in the shares of another, without express authority so to do, unless where expressly prohibited or the nature of its business render it improper so to deal. Re Barned's Banking Co., L. R., 3 Ch. 105; Re Asiatic Banking Co., L. R., 4 Ch. 252. In the latter of the cases first cited, Lord Justice SELWYN, in speaking of this power of corporations, said: "As to the capacity of a trading corporation to accept shares in another trading corporation, it is sufficient for me to say that I entirely agree with the judgment of Lord CAIRNS in the case of Barned's Banking Co., viz., that there is not, either by the common or statute law, anything to prohibit one trading corporation from taking or accepting shares in another trading corporation. There may, of course, be circumstances which prohibit or render it improper for a company so to do having regard to its own constitution, as defined by its memorandum and articles." It is in accordance with the statutes that the law is laid down as settled by Brice in his work on *Ultra Vires*, pp. 91, 92. And in this state the same principle has been fully sanctioned in the case of Elysville Manuf. Co. v. Okisko Co., 1 Md. Ch. Dec. 392, and same case affirmed on appeal in 5 Md. 152.

joint stock corporation organized "to do a general insurance agency commission and brokerage business and such other things as are incidental to and necessary in the management of that business," has been held in Connecticut to have no power to subscribe to the stock of a savings bank and building and loan association.[1] Though the power to borrow money may be implied in such a corporation, it cannot legally subscribe to such stock as a means of effecting a loan of money.[2] The power of an agricultural society to subscribe to stock in a street railway company which was to construct a street railroad through the streets of the city to the grounds of the society and to borrow money, secure it by assigning certain promissory notes of the railroad company and mortgage to secure them and to guarantee such notes in order to effectuate the purposes of the society, has been sustained by the Iowa Supreme Court.[3]

§ 68. Contracts of suretyship.— The Louisiana Supreme Court has held that there was no express authority given to the officers of the corporation involved in this case to enter into a contract of suretyship; neither was there any general authority

[1] Mechanics & Workingmen's Mutual Savings Bank & Building Association of New Haven *v.* Meriden Agency Co., (1855) 24 Conn. 159.

[2] Ibid. That a municipal corporation may be bound by a subscription to stock not authorized by its charter by subsequent legislative sanction, see First Municipality *v.* Orleans Theatre Co., 2 Rob. (La.) 209. In New Orleans, Florida & Havana Steamship Co. *v.* Ocean Dry Dock Co., (1876) 28 La. Ann. 173, the Louisiana Supreme Court held that the dock company could not subscribe to the capital stock of the navigation company, this being foreign to the object of its own charter. Purchasing stock of another company. Salomons *v.* Laing, 12 Beav. 339.

[3] Thompson *v.* Lambert, (1876) 44 Iowa, 239.

from which the power to enter into such a contract could be implied or fairly deduced under a plea of usage, necessity, convenience or public interest.[1] A corporation cannot by its officers execute a note for a debt due from a third person to another, having no relation to its business.[2] A manufacturing corporation, organized under the general laws of New York, has no power to indorse for the accommodation of another paper in which it is not interested.[3] And the indorsement of such paper by the treasurer of a manufacturing corporation may be presumed to be *ultra vires*.[4] But this rule has been adhered to, that while a corporation has no right to bind itself by an accommodation acceptance or indorsement, the corporation is liable on such acceptance or indorsement to a *bona fide* holder, although it was made for a purpose or at a place not authorized by the charter of the corporation.[5]

§ 69. Guaranty of bonds of one railroad corporation by another.— Upon a sufficient consideration one railroad corporation may guarantee the payment of the bonds of another.[6] It is

[1] Louisiana State Bank *v.* Orleans Navigation Co., (1848) 3 La. Ann. 294, in which case the powers of corporations at common law and under the Civil Code of Louisiana are fully discussed.

[2] Hall *v.* Auburn Turnpike Co., (1865) 27 Cal. 255.

[3] National Park Bank *v.* German-American Warehousing, etc., Co., (1889) 116 N. Y. 281; s. c., 26 N. Y. St. Repr. 675; Wahlig v. Standard Pump Manufacturing Co., (1889) 25 N. Y. St. Repr. 864; s. c., 5 N. Y. Supp. 420; citing Central Bank v. Empire Stone Dressing Co., 26 Barb. 23; Bank of Genesee *v.* Patchin Bank, 13 N. Y. 309. See, also, Bridgeport City Bank *v.* Empire Stone Dressing Co., 30 Barb. 421; Farmers & Mechanics' Bank *v.* Empire Stone Dressing Co., 5 Bosw. 275; Morford *v.* Farmers' Bank of Saratoga, 26 Barb. 568.

[4] Wahlig *v.* Standard Pump Manufacturing Co., (1889) 25 N. Y. St. Repr. 864; s. c., 5 N. Y. Supp. 420.

[5] Mather *v.* Union Loan & Trust Co., (City Court of N. Y. 1889) 26 N. Y. St. Repr. 58; s. c., 7 N. Y. Supp. 213; citing McCullough *v.* Moss, 5 Denio, 567; Mechanics' Banking Association *v.* New York, etc., White Lead Co., 35 N. Y. 505; Farmers & Mechanics' Bank *v.* Butchers & Drovers' Bank, 16 N. Y. 125. See, also, Usher *v.* Raymond Skate Co., (Mass. 1895) 39 N. E. Rep. 416; Savage Mfg. Co. *v.* Worthington, 1 Gill. 284; Madison, etc., R. R. Co. *v.* Norwich Saving Society, 24 Ind. 457, modifying Smead *v.* R. R. Co., 11 Ind. 104; LaFayette Savings Bank *v.* St. Louis, etc., Co., 2 Mo. App. 299.

[6] Low *v.* California Pacific R. R. Co., (1877) 52 Cal. 53. It appeared in this case that one railroad company, under authority of law, leased the line of another for a term of years. The consideration of the lease was an annual rental, and that the lessee company should guarantee the principal and interest of bonds to be issued by the lessee company. The contract of guaranty was challenged as *ultra vires*. The lessee company had no express authority to make such contract of guaranty, but did have power to make all such contracts as were usual and proper in the building and operation of a railway, and it likewise had power to lease the line of the lessor company. The Supreme Court held that the consideration was sufficient and the guaranty valid. They were of opinion that it was as competent for the company to promise to pay conditionally as to promise to pay absolutely; that the validity of the agreement depended upon the sufficiency of the consideration. The right to take the lease being express, it was a good consideration for the conditional promise involved by a contract of guaranty.

a good consideration for the guaranty of the bonds of one railroad corporation by another that the former conform its gauge to that of the latter and thus form running connections between the roads of the different corporations; and the guaranty of such bonds by a company empowered by general law of a state, "at any time, by means of their subscription to the capital stock of any other company, *or otherwise*, to aid such company in the construction of its railroad, for the purpose of forming a connection of said last-mentioned road with the road owned by the company furnishing such aid," is within the powers of the guaranteeing corporation.[1]

§ 70. Guaranty of bonds of railroad corporations by one of another kind.— In a very recent and elaborately considered case, the United States Circuit Court for the district of Kentucky has held that a land company, a Kentucky corporation, vested by its charter with large and extensive franchises and powers, had power to guarantee the bonds of a railroad company.[2]

[1] Zabriskie *v.* Cleveland, Columbus & Cincinnati R. R. Co., (1859) 23 How. 381. In Connecticut Mutual Life Insurance Co. *v.* Cleveland, Columbus & Cincinnati R. R. Co., (1863) 41 Barb. 9; s. c., 26 How. Pr. 225, the Supreme Court of New York held the arrangement entered into between several connecting railroad companies, for the purpose of securing a uniform gauge of the several roads, and thus increasing the business and profits of each, constituted a sufficient consideration for a guaranty by one of the corporations of the payment of the bonds of another; also that the general statute referred to in the text gave power to the companies whose lines were connected to enter into the arrangement as to a uniform gauge and to make it part of such arrangement that one or more of the companies should guarantee the payment of the interest coupons issued by another. See, also, Railroad Co. *v.* Howard, 7 Wall. 411.

[2] Tod *v.* Kentucky Union Land Co., (1893) 57 Fed. Rep. 47; affirmed by the United States Circuit Court of Appeals for the sixth circuit in Marbury *v.* Kentucky Union Land Co., (1894) 62 Fed. Rep. 335. LURTON, Circuit Judge, said: "The power to

§ 71. Circumstances surrounding corporation may authorize the guaranty.—The court applied the principles governing corporations in reference to their acts under the powers

execute accommodation paper, or to guarantee for accommodation the obligations of another corporation is not expressly conferred by the charter of the land company. Ordinarily, such power is not implied from the powers conferred upon corporations, and such contracts are generally in excess of the powers of corporations, and, therefore, void as *ultra vires*, in the true sense of the term. This proposition rested upon two or more very evident reasons: (1) The corporate funds belong to its shareholders, and, by the very terms of the law creating it, cannot be devoted to any other purposes than those indicated by its charter and constitution. Such obligations would violate the fundamental terms of the agreement between the corporators themselves. (2) To do so would be to exercise a power not conferred by the state, either expressly or impliedly. The state's grant of the corporate franchises is for the purpose prescribed, and the execution of such obligations would be beyond the power conferred, and, therefore, a diversion of the corporate purposes, as well as the corporate funds. (3) Such obligations rest upon no consideration, and would not, therefore, be valid. They would amount to a donation of the corporate funds, and, therefore, an unlawful diversion. Mor. Priv. Corp. 423; Davis *v.* Railroad Co., 131 Mass. 258; Madison Plank Road Co. *v.* Watertown Plank Road Co., 7 Wis. 59; McLellan *v.* File Works, 56 Mich. 579; s. c., 23 N. W. Rep. 321; National Park Bank *v.* German-American Mutual Warehousing & Security Co., 116 N. Y. 292; s. c., 22 N. E. Rep. 567; Ætna Nat. Bank v. Charter Oak Life Ins. Co., 50 Conn. 167. But there is no inherent want of power in a business corporation, having the power to execute negotiable paper, to obligate itself as a surety or guarantor. If such a corporation receive commercial paper or bonds in due course of business, we see no reason why, upon transferring such paper, it may not be lawful to obligate itself as indorser or guarantor. Such a contract would be a new and independent contract, and would rest upon a sufficient consideration, if entered into as a legitimate means of increasing the value of the security to be disposed of in the ordinary course of business. In Railroad *v.* Howard the question arose as to the liability of a railroad company upon its guaranty of certain bonds issued by various counties and cities, and received by the railroad company in payment of subscriptions to its stock. Upon full consideration it was held that, inasmuch as the company had received the bonds in payment of stock, and had a right to obligate itself by its own bonds for the purpose of building its road, it might lawfully, and in furtherance of its authorized purpose, guarantee such bonds as a means of augmenting their value on the market, thus producing funds to build its road. 7 Wall. 411, 412. The power of a corporation to bind itself by a guaranty, when it does so for its own benefit and as a means of selling at an augmented value, is generally conceded by the authorities. 'In such cases,' says Mr. Randolph in his work upon Commercial Paper (Vol. 1, § 334), 'the guaranty is an original contract of the corporation for its own benefit, the consideration moving to itself, and not to the person whose debt is guaranteed.' There being no

expressly granted and implied, referring to the general purposes, franchises, etc., embraced in the charter of this land company, to this particular case, showing wherein the circumstances surrounding it made it legal and proper that it should guarantee the bonds of the railroad company.[1]

absolute want of power in an ordinary business corporation to bind itself as a guarantor, we must next inquire as to the circumstances which will make such a contract lawful and obligatory. The cases already cited establish the proposition that if such a corporation has the power to issue bonds or other commercial securities, and becomes the holder of such bonds or securities issued by other corporations, it may indorse or guarantee them upon transferring them for the purpose of raising money to carry out any purpose for which it might borrow money. The right of a corporation to do an act or make a contract is not always a question of law. What it may not do under some circumstances, it may do under others. It may carry on the business it is authorized to do in the usual and customary manner that business of the same nature is carried on by individuals."

[1] Tod *v.* Kentucky Union Land Co., (1893) 57 Fed. Rep. 47. Referring to a special power granted the land company for a "temporary consolidation" with the railroad company, it was said: "The power to make a temporary consolidation, looking to all the four corners of the charter, clearly implies the power to make such an alliance or bring about such a union and co-operation of interests between the land company and a railway company as shall be to the mutual interest of each, and place both under the same control and management. This could be done by the plan suggested by Mr. Morawetz in section 942 of his work on Private Corporations, whereby the shares of one company should be held by the other or by the same persons. This meaning seems reasonable and proper, looking to the objects and purposes of this corporation, and any steps which brought about unity of interest and co-operation in purpose as being legitimate and authorized. Under this power we are of opinion that [this] land company had the power to acquire the shares in the railway company, and the right to exercise control over the railway company through the ownership and control of those shares. Undoubtedly the general rule is that a corporation has no implied power to acquire shares in another for the purpose of controlling it. Marble Co. *v.* Harvey, 92 Tenn. 115; s. c., 20 S. W. Rep. 427. This would be contrary to the well-understood public policy concerning such companies. But this objection does not lie here: (1) Because the charter of the railway company expressly provides that its shares may be owned by any other corporation. (2) The express power in the charter of the land company removes all objections, based on grounds of public policy, to its control of a railway company by and through its shares. What the legislature of Kentucky has expressly permitted cannot be void as against public policy in the absence of any violation of a constitutional provision. Under such circumstances it is not for the courts to say that what the legislature authorizes is unlawful because contrary to public policy. Having authority to acquire this stock, the land company became the sole stockholder in the railway company. Each had express authority to borrow

§ 72. Guaranty of dividend upon preferred stock of another corporation.— The court also held that this land company was authorized to guarantee a dividend upon the preferred stock of the railroad company.[1]

money and issue bonds to carry out the purposes of the organization. The completion of this railway was an object within the scope of its charter powers. It could do so by its own name or by aiding the railway company to negotiate its securities by guaranteeing their payment. The guaranty was not for the accommodation of the railway company. The guarantor being the sole shareholder of the railway company, it was a contract for its own benefit, and, therefore, rested upon a sufficient security. In addition, the land company was a creditor of the railway company, and was to, and did, receive the proceeds arising from the sale of the half million of these bonds. The remainder of the money thus raised was to be applied to the building of the railway line. The consideration was sufficient to fully support the contract. A like question arose in Chicago, R. I. & P. R. Co. *v.* Union Pac. Ry. Co., 47 Fed. Rep. 16, where Mr. Justice BREWER held that 'where one railroad company owns substantially all the stock of another railroad company, a lease of the latter line for rent to be paid to the former company is not void for want of consideration since it amounts merely to an agreement to pay the rent directly to the stockholders.' Upon appeal to the United States Circuit Court of Appeals for the fifth circuit, this ruling was affirmed. 51 Fed. Rep. 329; s. c., 2 C. C. A. 242. The directors of the railway company held the property of that company, including these bonds and their proceeds, when sold, in trust for the * * * land company as holders of the shares in that company. To say that its guaranty of these bonds was a mere accommodation guaranty when it was the *cestui que trust* in the proceeds of the bonds, and thereby enable it to defeat its responsibility, as a contract *ultra vires*, would be sticking in the bark and result in manifest injustice. That at some future day this union may be dissolved by a sale of the stock owned by the land company is not of importance. The real and substantial owner of the railroad company at the time these bonds were guaranteed was the land company. The guaranty was for the benefit of the guarantors. Union Pac. Ry. Co. *v.* Chicago, R. I. & P. Ry. Co., 51 Fed. Rep. 310; s. c., 2 C. C. A. 174. The case is not like that of Davis *v* Railroad Co , 131 Mass. 258. That was a donation to support a musical festival. The benefit to the railroad company was in the supposition that it would profit by increased travel. This was altogether too remote, and the contract properly held void. When the question is, as here, whether or not a particular act is *ultra vires*, decided cases are of little value. Each case must be largely a question of fact. Yet, by reference to a few of the decided cases, we can discover the principle upon which other courts have proceeded in deciding such questions. We will refer to a few cases: In Louisville & N. R. Co. *v.* Literary Society of St. Rose, 91 Ky. 395; s. c., 15 S. W. Rep. 1065, the Court of Appeals of Kentucky passed upon a question involving the implied power of a corporation. It appeared that the literary society of St. Rose and the literary society of St. Catherine were corporations for educational purposes, existing in or near the town of Springfield in Washington county, Kentucky. They had power to contract and to buy and sell real and personal property for the purpose of sustaining and carrying

on said institutions of learning and not otherwise. Each of them owned and operated a farm of about 1,000 acres of very considerable value. This, in the language of the court, 'created a large industry in the way of supplies furnished to them, and they in turn furnishing to others.' Each of these corporations signed an obligation to a railroad company to induce it to extend its line near their property. In an action upon those obligations, it was contended that they were *ultra vires*. The court said: 'Corporations derive their powers from charters. They are those which are expressly given or by fair implication are necessary to the execution of their object. Cases may be found where the officers of a corporation have exceeded their powers, but the corporation, nevertheless, held liable because the transaction was within the scope of its business, and it had received a benefit from it. The only trouble arose from a defect of power in the managers. This case is not within this class, however, because it appears beyond all doubt that the change of location as to depot was not to the interest of these institutions. The building of the road was calculated, however, to be highly beneficial to them, both as to furnishing convenient access to them for persons coming and going, and also in furnishing them a means of obtaining their supplies and sending their products to market. It was calculated to and undoubtedly did add greatly to the value of their properties and the large industries which their charters had authorized them to create. It conferred a direct benefit. The power existed by fair implication to do anything reasonably calculated to add to their value. How far this power extended we need not decide. Certainly, however, if during a portion of the year these institutions had been almost inaccessible for the lack of a turnpike or a bridge, a subscription by them to build either would have been valid; and while not authorized to enter into all manner of speculations, yet, in our opinion, a subscription by them to aid the building of this road was not, under all the circumstances, *ultra vires* and, therefore, void.'"

[1] Tod *v.* Kentucky Union Land Co., (1893) 57 Fed. Rep. 47, affirmed by United States Circuit Court of Appeals for the sixth circuit in Marbury *v.* Kentucky Union Land Co., (1894) 62 Fed. Rep. 335. This "guaranty," the court said, "stands upon the same footing as the guaranty of the bonds. The temporary consolidation between the two companies, springing out of the ownership of the stock in the railway company by the land company, in view of the terms of the charter of the latter company, authorized it to aid the former in any usual way to build its line of railroad." Certain second mortgage bonds of the railroad company were issued and delivered to the land company on account of indebtedness due by the railway company to the land company. A large part of these bonds had been sold by the land company, and were in the hands of various individuals who held them as *bona fide* purchasers for value. When sold, the payment of these bonds, principal and interest, was guaranteed by the land company. Others had been pledged as collateral security, and these, also, were guaranteed by the land company. As to these bonds the court said: "The bonds, having been received in payment of, or on account of, indebted-

§ 73. What contract of another corporation may not be guaranteed.— The United States Circuit Court of Appeals for the sixth circuit has held that a corporation organized under the law of Ohio for the purpose of making iron work for mining plants had not the power to guarantee the performance of another's contract for the erection of a mining plant, and the accompanying warranties, on the ground that the guaranty would secure a sale of the iron work used in the plant.[1] Further, the performance of such contract on the part of the party to whom the guaranty was given did not estop the corporation from denying its power to give the guaranty.[2]

§ 74. Athletic club.— A corporation formed under a statute for encouraging athletic exercises, under a provision of the statute that it "may hold real and personal estate, and may hire, purchase or erect suitable buildings for its accommodation to an amount not exceeding five hundred dollars," has power to take a lease of land, and to erect a suitable club house upon it. Having such power it may raise money for the purpose by negotiating a loan and giving its promissory note for its payment.[1] Additional authority given in the statute "to receive and hold in trust funds received by gift or bequest" will not confine it to that mode of raising it.[2]

ness, became the property of the [land company]. To augment their value when sold, or pledged as collateral, their payment was guaranteed. It is true that when this guaranty was placed upon the bonds, the clause in the charter of the land company permitting a consolidation with a railroad company had been repealed. Inasmuch, however, as the connection between these two companies was authorized when the latter acquired the stock of the former, and paid or assumed its debts, and inasmuch as this alliance, union or 'temporary consolidation' was in force when this repealing act took effect, and when these bonds were guaranteed, we think it was not prohibited by the repeal from continuing the union of the two companies, or obligating itself by this guaranty. The amendment should be construed as prospective and not retrospective. Any relation which had theretofore been entered into with this railway company was not affected by the amendment, and all which could be lawfully done by reason of such existing lawful union might thereafter be done, so long as it continued. Irrespective of the particular power resulting from the 'temporary consolidation,' and the relations resulting therefrom, this obligation of the land company is valid, under the authority of the cases holding that a corporation having the power to bind itself by commercial paper might indorse or guaranty commercial obligations received in ordinary course of business, and guaranteed when sold to augment the price realized in their sale and transfer." As to guaranteeing dividends, see Colman *v.* Eastern Ry. Co., 10 Beav. 1; Logan *v.* Earl of Courtown, 13 Beav. 22.

[1] Humboldt Min. Co. *v.* American Manufacturing, Mining & Milling Co., (1894) 62 Fed. Rep. 356.

[2] Ibid.

§ 75. Banking associations.— The General Banking Law of New York did not give banking associations power, in express terms, to borrow money; but, notwithstanding this fact, the Supreme Court held that as such an association might become indebted, in the exercise of its undoubted legitimate business, it had, as a necessary incident, the power to borrow money for the purpose of paying its debts.[3] The Court of Appeals of New York, in a case between the receiver of this same banking association and other parties, held to the same effect that these banking associations had capacity to borrow money as incidental to the banking business and to the powers expressly granted.[4]

[1] Bradbury *v.* Boston Canoe Club, (1891) 153 Mass. 77; s. c., 26 N. E. Rep. 132.

[2] Ibid. Citing Fay *v.* Noble, 12 Cush. 1.

[3] Leavitt *v.* Blatchford, (1848) 5 Barb. 9. Edwards, J., for the court, said: "Without reference to the banking law, it is a general fundamental principle, that when a right is given, all powers are given which are necessary to the exercise and enjoyment of the right. Now, it cannot be questioned that a banking association may become indebted, in the exercise of its undoubted legitimate business. It has the right to receive deposits, and it must become indebted for them. It has the right to purchase gold and silver bullion, foreign coins and bills of exchange; and it may become indebted upon such purchase. It requires state stocks as a basis of its circulation, and it may lawfully contract a debt in the purchase of state stocks for that purpose. There may be other ways in which a banking association can become legally indebted. It may become liable for the payment of its debts at a time when, owing to disappointment, unexpected losses, or some unforeseen casualty, it has no available assets to meet its engagements. This emergency may occur in the soundest and best-regulated association. The question then must arise, whether a solvent institution is to fail to meet its liabilities, and be broken up and ruined, or whether it shall be permitted to substitute a credit for some convenient period of time, in the place of a debt then due and payable, or, in other words, whether it can substitute one creditor in the place of another. The power to borrow then is a necessary incident to the power to become indebted. It is a power without which no banking association could safely carry on its business."

[4] Curtis *v.* Leavitt, (1857) 15 N. Y. 9. Comstock, J., in the opinion rendered by him, on page 63, stated the doctrine in Barry *v.* Merchants' Exchange Company, 1 Sandf. Ch. 280, 289, in the language of Assistant Vice-Chancellor Sandford: "A corporation, in order to attain its legitimate objects, may deal precisely as an individual may, who seeks to accomplish

§ 76. A savings bank's powers.— Every corporation created for transacting business, unless restrained by its charter or some statute, has, as a necessary incident, the power of incurring debts in the course of its legitimate business. For instance, in the case of a savings bank it was held that it had the power to negotiate a loan from another bank and of making and indorsing negotiable paper in payment of such debts.[1]

the same ends. If chartered for the purpose of building a bridge, it may contract a debt for labor, the materials, or the land upon which the bridge is abutted. If more advantageous, it may borrow money to purchase such land or materials, or to pay for such labor, and as the evidence of the indebtedness, it may execute to the creditors a note, a bond, or a mortgage, whether the debt be for the money borrowed, or the work, materials, or land." COMSTOCK, J., said, on pages 64, 65: "I confess my own inability to refute the doctrine so perspicuously laid down by Assistant Vice-Chancellor SANDFORD. I am not aware that it comes in conflict with any known distinction between private persons and corporations. It is true that the latter take all their powers, direct and incidental, under their charters; but when the direct power is granted in terms, they take it, as a natural person enjoys it, with all its incidents and accessories. A simple association of merchants to build an exchange could, if they so agreed with each other, very appropriately borrow money in furtherance of the object, and why can they not, if they take the principal power under a charter from the government, which enables them to act as a single person, and with a collective will? It is truly said that corporations can only exercise such incidental powers as are necessary to carry into effect the express objects of their charters. But necessity is a word of flexible meaning. There may be an absolute necessity, a great necessity and a small necessity, and between these degrees there may be many others depending on the ever varying exigencies of human affairs. It is plain that corporations, in executing their express powers, are not confined to means of such indispensable necessity that, without them, there could be no execution at all. The entire doctrine would lead at once to a very great absurdity, for if there are several modes of accomplishing the end, neither one is indispensable, and each would exclude all the others. And thus, by inevitable logic, an express grant of power would lie forever dormant because there are more modes than one of carrying it into execution. It is almost as difficult to say that the incidental power depends for its existence on the degree of necessity which connects it with the power in chief. Such a doctrine would impose upon courts a never-ending difficulty, for the inquiry would plainly be whether the chosen instrumentality is the very best that could be selected, and if not the very best, however minute the difference may be, then the inevitable decision must follow that the choice was fatally bad, although strictly adapted to the end in view, and made in the utmost good faith. These demonstrations, for such they appear to me, would seem to leave but one other conclusion, which is, that corporations, along with their specific powers, take all the reasonable means of execution, all that are convenient and adapted to the end in view, although not the very best by many degrees of comparison. And this is a doctrine which must necessarily result in the liberty of choice amongst those means. The choice may be wise or unwise. If made in the exercise of an intelligent good faith, the wisdom of the selection may be called in question, but the power to make it cannot be. I can, therefore, see no room for the distinction which admits the power of a corporation to contract a debt for labor and materials to be used in building an exchange, or a bridge, or a turnpike road, or in manufacturing, those being in each case the specified object of the charter, but denies the right to borrow money to be used in the purchase of the same labor and materials. If there be any reason for a distinction, resting on a comparison of benefit to the corporation, the advantages of borrowing would in most cases be undeniable. So, in point of public policy, the reason for that preference would appear to be still stronger, for while the industrial classes would require no protection, the money lenders could safely be left to guard their own interests. I believe the distinction referred to is not recognized by any adjudged case." BROWN, J., discusses these questions in his opinion, pages 157–161; SHANKLAND, J., in his opinion, pages 166–169; PAIGE, J., in his opinion, pages 210–213.

[1] Fifth Ward Savings Bank *v.* First National Bank, (1886) 48 N. J. Law, 513. DEPUE, J., speaking for the Court of Errors and Appeals of New Jersey, said: "Savings banks are established for business purposes. Their functions are to receive, hold and invest moneys that may be deposited with them, and to repay the money deposited under reasonable regulations in their by-laws. In order to make the business successful, these institutions are required to keep their money invested as closely as may be consistent with the ordinary demands of depositors. But in seasons of financial excitements they may be subjected to extraordinary demands from depositors, to meet which and save the credit of the institutions, large sums of money may be required to be raised on sudden and unforeseen contingencies. At such times, the securities such institutions usually hold are likely to be depressed in the market and unsalable except at ruinous sacrifices. If these institutions should not have the power to borrow money and to make negotiable paper, or make a pledge of securities on which money

§ 77. Corporations dealing in lands.— The Supreme Court of California has held that "where a corporation was formed for the purpose of dealing in and speculating in real estate, and with the express power "to buy, improve, sell, lease and otherwise dispose of real estate" the term "improve" included the performance of any act, whether on or off the land, the direct and proximate tendency of which was to benefit or enhance its value. Therefore, a subscription made by such a corporation to a railroad company for the purpose of increasing the facilities and lessening the cost of transportation on the same, "where the direct and proximate tendency of such increase of facilities is to enhance the value of its lands" was held a valid and binding

contract.[1] In a Pennsylvania case, where a corporation owned a large body of wild land and had power by its charter "to aid in the development of minerals and other materials, and to promote the clearing and settlement of the country," the Supreme Court held that the building of saw mills and a hotel for the accommodation of those having business in connection with carrying out the prime object of the corporation was within its powers.[2] The Kansas Supreme Court, in an opinion delivered by Mr. Justice BREWER, now of the United States Supreme Court, held that where a corporation was created for the purpose of locating and laying out a town site, and making improvements thereon, it was within the power of such corporation to donate lands for the purpose of securing the erection and maintenance of a school upon property adjacent to that owned by the town site company; "that the direct and proximate tendency of the improvements sought to be obtained by the donation is the building up of the town, and the enhanced value of the remaining property. The purpose of the corporation is to build up the town, * * * and this purpose is directly furthered by such a donation."[3] In the United States Circuit Court for the western district of Virginia it was held that an improvement company organized under an act of the legislature of that state, to buy and sell lands, erect, sell and lease buildings, to grade and improve streets, to furnish gas, electric light and water works, to construct and operate street railways, furnaces and mills, and to acquire by purchase or subscription the stock or bonds of any mining, manufacturing, water, gas, street railway, or other improvement company, had power to give part of its stock to a railway company in order to enable the latter to complete its line to the property of the improvement company.[4] A corporation created for the purpose of dealing in lands, and to which the powers to pur-

may be borrowed temporarily, great sacrifices in the sale of the securities in which the trust funds are invested, if not financial ruin, would be the probable result of every unexpected run upon the bank by depositors to withdraw their deposits. It is the existence of conditions and contingencies of this kind likely to arise in the conduct of business that the law recognizes as the ground for raising by implication a power in corporations to borrow money and give negotiable security as a means of borrowing."

[1] Vandall *v.* Dock Co, 40 Cal. 84.

[2] Watts' Appeal, 78 Pa. St. 370.

[3] Whetstone *v.* University, 13 Kans. 320.

[4] McGeorge *v.* Big Stone Gap Imp. Co., (1893) 57 Fed. Rep. 262.

chase, to subdivide, to sell, and to make any contract essential to the transaction of its business are expressly granted, possesses as fairly incidental the power to incur liability in respect of securing better facilities for transit to and from the lots or lands which it is its business to acquire and dispose of.[1]

§ 78. **Insurance corporations.**— A corporation created for the purpose of carrying on the business of insurance, with power to convert its bonds and stocks into cash, when needed, to pay risks, may, through its president borrow money and pledge its stock as collateral security.[2] A corporation organized under the law of Indiana providing for the organization of life and accident insurance companies, has power to borrow money and secure its payment by mortgaging its real estate.[3] The power to contract and be contracted with, is one of the common-law incidents of a corporation. Unless expressly restrained by its charter, every corporation has the incidental power to make any contract, and

[1] Fort Worth City Co. *v.* Smith Bridge Co., (1894) 151 U. S. 294; s. c., 14 Sup. Ct. Rep. 339, affirming a judgment in favor of the bridge company upon a contract to build a bridge over a river for which the corporation agreed to pay a portion in its bonds. FULLER, Ch. J., quoted in his opinion as follows: In Green Bay & Minnesota Railroad *v.* Union Steamboat Co., 107 U. S. 98, 100, it was said: "The charter of a corporation, read in connection with the general laws applicable to it, is the measure of its powers, and a contract manifestly beyond those powers will not sustain an action against the corporation. But whatever, under the charter and other general laws, reasonably construed, may fairly be regarded as incidental to the objects for which the corporation is created, is not to be taken as prohibited. * * *" Further on, he said: "The object of the creation of the corporation was the acquisition and sale of lands on subdivision, and it cannot successfully be denied that that object would be directly promoted by the use of legitimate business methods to render the lands accessible. This involved the expenditure of money or the assumption of liability, but there is no element in this case of any unreasonable excess in that regard, or of the pursuit of any abnormal and extraordinary method. The result sought was in accomplishment of the legitimate objects of the corporation and essential to the transaction of its authorized business, and the power to make the contract was fairly incidental if not expressly granted." See, also, North Side Ry. Co. *v.* Worthington, (Tex. Civ. App. 1894) 27 S. W. Rep. 746, following the case above.

[2] Bezou, Commissioner, *v.* Pike, (1871) 23 La Ann. 788. The court distinguished Levy *v.* Mutual Benefit Life & Fire Ins. Co., 8 La Ann. 380, in that the directors in that case did an act in conflict or inconsistent with an express provision of the charter.

[3] Wright *v.* Hughes, (1889), 119 Ind. 324; s. c., 21 N. E. Rep. 907.

evidence it by any instrument that may be necessary and proper to accomplish the objects for which it is created. A note or bill, therefore, made or received by such a corporation is *prima facie* within its corporate powers, and, therefore, valid.[1] But when such a transaction is drawn in question, it is always competent to show that it was given or taken for a purpose not authorized, and when shown, the contract is void, and the instrument a nullity.[2] A mutual life insurance company has been held in Connecticut to have the power, as incident to its business of insuring lives, to provide a guaranty fund by taking the notes of responsible parties, payable only if required for the purpose of meeting losses, and allowing a reasonable compensation to the makers of the notes for the use of their credit.[3] A corporation clothed by its charter with power to transact the business of life, fire, and marine insurance, receive money on deposit, collect

[1] Straus & Bro. *v.* Eagle Insurance Co. of Cincinnati, (1855) 5 Ohio St. 59; N. Y. Firemen Insurance Company *v.* Sturges, 2 Cow. 664; Barker *v.* Mechanic Fire Ins. Co., 8 Wend. 94.

[2] Straus *v.* Eagle Insurance Co. of Cincinnati, (1855) 5 Ohio St. 59; Broughton *v.* Manchester Water Works, 3 Barn. & Ald. 1; Munn *v.* Commission Co., 15 Johns. 44; New York Firemen Ins. Co. *v.* Ely, 2 Cow. 678; N. Y. Firemen Ins. Co. *v.* Bennett, 5 Conn. 574; Philadelphia Loan Co. *v.* Towner, 13 Conn. 249; Korn *v.* Mut. Soc., 6 Cranch, 199; Bank of Chillicothe *v.* Swayne, 8 Ohio, 257; McCullough *v.* Moss, 5 Denio, 567; Slark *v.* Highgate Archway Company, 5 Taunt. 792.

[3] Hope Mutual Life Ins. Co. *v.* Weed, (1859) 28 Conn. 51. The court said: "It was an arrangement which was made, not as an end, but only as a means or instrument for the successful prosecution of their main and appropriate business. And the facts before us conclusively show that such, in the present instance, was the only design or motive with which it was entered into, and that it was resorted to by the plaintiffs as a matter necessary to the prosecution of their proper business, and was shown by experience to be such. We cannot, therefore, pronounce that arrangement to be an illegitimate exercise of the powers conferred by their charter. Indeed, if we were to declare it invalid on this ground, we do not see why the broad ground must not be taken that, in the case of any corporation created for the purpose of carrying on a particular kind of business requiring credit in its prosecution, it would be an excess of its power to engage or secure, in support or aid of its own credit, that of other persons in regard to the fulfillment of its contracts, even when the exigencies of its business required such aid for its prosecution; and the principle would even go so far as to prohibit the ordinary engagement of suretyship in behalf of such corporation. Nothing is more common than the exercise of such a power by our pecuniary corporations, and the power is one from the exercise of which not only no evil, but the greatest benefits to such corporations and to the public, has arisen. And it was never before suggested that it was beyond the scope of the powers granted to such bodies."

promissory notes, and bills of exchange, lend money, and discount or sell such notes or bills, and to "borrow money and issue its bonds therefor," is not restricted by this latter provision to making loans secured by bonds, but has the incidental and implied power, common to all such corporations, to borrow money, and make negotiable, or non-negotiable paper, and give such securities as may be deemed most advantageous.[1] Under statutory authority to "invest their money in real or personal property, stocks or choses in action" an insurance corporation cannot subscribe for stock in a projected corporation.[2]

§ 79. **Manufacturing corporations.**— A corporation organized under the General Incorporation Act of Ohio, for the purpose of manufacturing and supplying gas to the inhabitants of a city or village, may borrow money to enable it to accomplish the legitimate objects of its creation, and secure the payment of the loan by note and a mortgage upon its property.[3] A corporation, incorporated "for the purpose of manufacturing and selling glass" may purchase glassware, for the purpose of keeping up their stock and supplying customers, while the works which they manufacture in are being put in repair.[4] A manufacturing corporation may incur a liability for a stock of merchandise to be sold by it in a retail store connected with their manufacturing

[1] Talladega Insurance Co. *v.* Peacock, Admr., (1880) 67 Ala. 253; Allen *v.* Montgomery R. R. Co., 11 Ala. 454; Mobile & Cedar Point Ry. Co. *v.* Talman, 15 Ala. 491; Lucas *v.* Pitney, 27 N. J. Law, 221; Railroad Company *v.* Howard, 7 Wall. 411. In Trenton Mutual Life & Fire Insurance Co. *v.* McKelway, (1858) 12 N. J. Eq. 133, 136, Chancellor WILLIAMSON said: "It cannot be denied but that the corporation might borrow money under some circumstances, and that a contract *bona fide* made for such loan would be illegal [legal?], and not in contravention of the charter. For instance, should the corporation incur a loss, and not have the available means promptly to meet it, it would not be illegal for them to make a loan to meet the exigency."

[2] Commercial Fire Insurance Co. *v.* Board of Revenue of Montgomery County, 99 Ala. 1; s. c., 14 So. Rep. 490.

[3] Hays *v.* Galion Gas Light & Coal Co., (1876) 29 Ohio St. 330.

[4] Lyndeborough Glass Co. *v.* Massachusetts Glass Co., (1873) 111 Mass. 315. The court said: "They succeeded a former company which had been engaged in the same business; it was important that they should retain the old customers. They were repairing their manufactory and machinery and these goods were bought to keep in their stock and enable them to fill orders from their customers until they could supply themselves from their own manufactory. Such purchases are auxiliary and incidental to the main purposes of their incorporation

business, as a convenience or necessity thereto.[1] A corporation manufacturing machinery may purchase cotton for use in packing its manufactures for cash or on credit and give its evidences of debt for the same.[2] A manufacturing and mercantile corporation may incur a liability in the nature of a reward to one causing the apprehension of persons charged with crime and their conviction.[3]

§ 80. Mining corporations.—The power to borrow money is an incident to the corporate powers of a mining corporation.[4] It is a necessary incident of a mining corporation that it shall have power to contract and to bind itself to those dealing with it in matters within the intent of the charter, even though the charter contains no express grant or power to contract or incur indebtedness.[5] A corporation, the purpose of which by the act creating it is to mine and transport coal, may purchase and use a steamboat for the purpose of transporting and delivering coal.[6] A corporation organized for mining purposes has power to purchase timber.[7] But it has no authority to issue accommodation paper and deliver it to strangers.[8] The board of directors of a

and are fairly within the scope of the powers conferred upon them by law. Brown *v.* Winnisimmet Co., 11 Allen, 326."

[1] Dauchy *v.* Brown, (1852) 24 Vt. 197.

[2] Gist *v.* Drakely, 2 Gill, (Md.) 330, 345.

[3] Norwood & Butterfield Co. *v.* Andrews, (1894) 71 Miss. 641; s. c., 16 So. Rep, 262. Citing Railroad Co. *v.* Cheatham, 85 Ala. 292; s. c., 4 So. Rep. 828; Ricord *v.* Railroad Co., 15 Nev. 167; Express Co. *v.* Patterson, 73 Ind. 430. In National Bank of Republic *v.* Edward C. Young, Receiver, etc., (1886) 41 N. J. Eq. 531, it was held that a corporation created for the purpose of carrying on a manufacturing business had implied power to make negotiable paper for use within the scope of its business, but no power to become a party to bills or notes for the accommodation of others. In Sumner *v.* Marcy, 3 Woodb. & M. 105, it was held that a manufacturing corporation could not legally invest money in a bank for the purpose of carrying on the banking business; nor could it issue promissory notes in payment of shares in a banking company which would bind the corporation or its members. As to the incidental power of a private corporation to make any contract necessary to advance the objects for which it was created, see Legrand *v.* Manhattan Mercantile Association, (1880) 80 N. Y. 638, affg. 44 N. Y. Super. Ct. 562.

[4] Kent *v.* Quicksilver Mining Co., (1879) 78 N. Y. 159.

[5] Wood Hydraulic Hose Mining Co. *v.* King, (1872) 45 Ga. 34.

[6] Callaway M. & M. Co. *v.* Clark, (1862) 32 Mo. 305.

[7] Adams Mining Co. *v.* Senter, (1872) 26 Mich. 73.

[8] Beecher *v.* Dacey, (1881) 45 Mich. 92.

mining corporation which is empowered to enter into any contracts essential to its ordinary business may borrow money for the purposes of the corporation and invest certain of its officers with power to negotiate loans, etc.[1] That such officers have been invested with power to negotiate loans, etc., may be shown otherwise than by official record of the board's proceedings.[2]

§ 81. Railroad corporations.—A corporation incorporated for the construction of a railway has power to agree to pay for its right of way in bonds.[3] A railroad company, granted a right to construct a particular line of road, with general power to purchase all kinds of property of whatever nature, may purchase from another railroad company a road constructed on that line if the latter company has the power to sell it.[4] Corporations created for the construction of railroads, in the absence of limitation or restraint by statute, have power to borrow money and to make bonds, bills or promissory notes for its repayment, and also power to mortgage their property, real or personal, as a security for such evidences of debt. These are powers necessary and proper to enable them to accomplish the purposes of their creation, and are regarded as incidental or implied, though not expressly conferred by the charter or act of incorporation.[5] A railroad corporation, with power to construct and maintain a railroad, cannot, however, incur a debt for an examination of mines along its route by an expert and a report upon the extent of the output of the same, this being a matter not within the legitimate purposes of its creation.[6]

§ 82. The same subject continued.—A railroad company has no right, under an authority to borrow money, to raise money

[1] Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192.

[2] Ibid.

[3] Munson *v.* Syracuse, Geneva, etc., R. R. Co., (1886) 103 N. Y. 58; s. c., 4 Cent. Rep. 191.

[4] Branch *v.* Jesup, 106 U. S. 468.

[5] Kelly *v.* Trustees of Ala. & Cinn. R. R. Co., (1877) 58 Ala. 489; Richards *v.* Railroad, 44 N. H. 127; Commonwealth *v.* Smith, 10 Allen, 448; Savannah & Memphis R. R. Co. *v.* Lancaster, (1878) 62 Ala. 555 As to the implied power of a corporation to borrow money needed for its legitimate purposes, and give security therefor to the lender, see In re Patent File Co., L. R. (6 Ch.) 83; Monument Nat. Bank *v.* Globe Works, 101 Mass. 57; Hays *v.* Galion Gas Light Co., 29 Ohio St. 330; Curtis *v.* Leavitt, 15 N. Y. 9.

[6] Georg *v.* Nevada Central Railroad Co., (Nev. 1894) 38 Pac. Rep. 441; citing Thomas *v.* Railroad Co., 101 U. S. 82; Davis *v.* Railroad Co., 131 Mass. 259.

by the issue of irredeemable bonds entitling the holder merely to a share of the earnings after the payment of a certain dividend to the stockholders; neither has it the right to issue interest-bearing bonds, secured by mortgage, if a portion of such bonds are perpetual.[1] Under the laws of Wisconsin railroad companies were given power to make such contracts with railroads terminating on the eastern shore of Lake Michigan, within the state of Michigan, as would enable them to run their roads in connection with each other, etc., and to "build, construct and run as a part of their corporate property such number of steamboats or vessels as they may deem necessary to facilitate their business. The Supreme Court of the United States has held that, under the power given by the above-mentioned statutes, a railroad company could contract with a steamboat company to run in connection with its line, and might lawfully guarantee that their earnings should not fall below a certain sum.[2] A cor-

[1] Taylor *v.* Philadelphia & Reading R. R. Co., (1881) 7 Fed. Rep. 386. McKennan, C. J., referring to the proposition to issue such bonds, said: "It does not propose to create the relation of debtor and creditor between the defendant and the subscribers. The money obtained by the defendant could not be regarded as borrowed, because that implies reimbursement, and it is not demandable by the subscribers or payable by the defendant. It has not the essential and distinguishing qualities of a loan. It contemplates a stipulation that the subscribers, in consideration of the sums paid, not lent, by them, shall be entitled to receive, in a remote and uncertain contingency, a portion of the defendant's earnings, to be measured by a certain rate per cent upon three times the sums paid by them, and after that shall participate with the common shareholders in the division of the residuary earnings. By what allowable definition of a loan or borrowing such a transaction can be embraced I am at a loss to conceive." Butler, D. J., concurring, said upon this question: "Every admissible definition of the term borrow or loan, as applied to money and commercial transactions, embraces an obligation to return the property borrowed. A loan of money is universally understood to be the delivery of a certain sum to another on contract for its return, generally with interest, as compensation for its detention and use. To call the payment of money to another, who is to receive and permanently retain it as his own, in consideration of an annual benefit or profit, a *loan*, would seem to be a plain misuse of language." See Kent *v.* Quicksilver Mining Co., 78 N. Y. 159, 177; Burt *v.* Rattle, 31 Ohio St. 116.

[2] Green Bay & W. R. Co. *v.* Union Steamboat Co., 107 U. S. 98; s. c , 2 Sup. Ct. Rep. 221, in which case Justice Gray said: "Whatever under the charter or other general laws, reasonably considered, may fairly be regarded as incidental to the objects for which the corporation is created, is not to be taken as prohibited." In Pearce *v.* Madison & Indianapolis R. R. Co., (1853) 21 How. 441, the Supreme Court of the United States held that the purchase of a steamboat by the railroad corporation, to be run in connection with its business, was not authorized by its charter or within its power as necessary or incident to its business, and that there could be no recovery upon the notes given for its purchase. The court cited in support of their ruling: MacGregor *v.* The Official Manager of the Deal & Dover Railway, 16 Eng. Law & Eq. 180; Colman *v.* Eastern Counties Railway Co., 10 Beav. 1; East Anglian Railways Co. *v.* Eastern Counties Railway Co., 11 C. B. 803; Head *v.* Providence Insurance Co., 2 Cranch, 127; Bank of Augusta, *v.* Earle, 13 Pet. 519; Perrine *v.* Chesapeake & Delaware Canal Co., 9 How. 172.

poration formed for the purpose of constructing a railroad cannot engage in the business of running a line of steamers.[1] Neither can it engage in the banking business in order to raise a fund with which to construct or operate its road.[2] Authority in the charter of a railroad corporation to "obtain by purchase or grant * * * any steamboats * * * that the said directors may deem necessary, profitable and convenient for this corporation to own, use and manage in connection with its said railroads" does not carry with it the power to buy off an opposition line of steamers with a view not of employing but of withdrawing them from the field of competition.[3] The power to issue to contractors in payment for work due negotiable certificates of indebtedness, payable in money or bonds, is included in the power granted a railroad corporation by its charter to build a road and issue bonds to pay therefor.[4]

§ 83. Raising money by borrowing notes and indorsement of them.— In a leading New Jersey case, the president and directors of a railroad company agreed among themselves that they would execute their individual several notes to the company and the latter should raise money upon them for the purposes of the corporation. The note involved in this action was never directly negotiated by the company to raise money, but was indorsed by the company as a renewal of former such notes and finally delivered to one to whom the company was indebted for money, in payment of that indebtedness. It was insisted before the Court of Errors and Appeals that the provision in the charter of the company "that the said corporation shall have power to borrow such sum or sums of money from

[1] McCarty *v.* Roots, 21 How. 432.

[2] Waldo *v.* Chicago R. R. Co., 14 Wis. 575, 580.

[3] Morgan & Raynor, Trustees, *v.* Donovan, (1877) 58 Ala. 241.

[4] Pusey *v.* New Jersey West Line R. R. Co., (1873) 14 Abb. Pr. (N. S.) 434.

time to time, as shall be necessary to build, construct or repair said road, and furnish the said corporation with all the necessary engines and machinery for the uses and objects of the said company, and to secure the payment thereof by bond or mortgage, or otherwise," was a limitation of the power of the company to borrow money for specified purposes, and in the mode designated, and was tantamount to a prohibition of the company's borrowing money for any other purpose or upon any other security than that specified. The court held that it was within the power of the company to raise money through borrowing these notes and indorsing them to others for its indebtedness.[1]

[1] Lucas *v.* Pitney, (1858) 27 N. J. Law, 221. Chief Justice GREEN in the opinion rendered said that this section of the charter "was designed not as a limitation or restriction of the powers of the corporation, but as a grant of additional power. * * * The corporations are clothed with powers, which, independent of that provision, they could not have exercised. But there is nothing in the provision which, by necessary implication or by fair intendment, can be construed to limit the general powers and capacities incident to every corporation." On the part of the defendant, it was insisted that a corporation can make no contract which is not necessary to enable it to answer the object of its incorporation; that the loaning of money, or the borrowing of notes to be discounted in market, is not necessary to the operation of a railroad company; and that, consequently, the making or indorsement of commercial paper by such company as a security for money loaned and the indorsement of notes borrowed for the purpose of raising money were void acts. To this insistment the chief justice said: "The simple inquiry is whether a railroad company has, as a necessary incident, the inherent power of borrowing money for the payment of its debts or for its necessary purposes. It is conceded that the corporation has such powers only as are expressly conferred by charter or necessarily incident to those powers. If it may lawfully contract debts, it would seem clear that it may enter into obligations to pay those debts or borrow money for that purpose. The power of incurring debts in the course of its legitimate business, of giving notes, or borrowing money for the payment of such debts would seem necessarily incident to every corporation whose business involved the expenditure of large sums of money, and often upon sudden and unforeseen contingencies. Such it is believed is the universal custom of all important corporations whether private or municipal. The authorities in support of the practice are abundant. Our statute recognizes bodies politic or corporate as persons by whom promissory notes and bills of exchange may be drawn, indorsed and accepted. Nix. Dig. 667, § 4 (N. J.). The technical doctrine that a corporation can contract only under its corporate seal, was long since exploded. In Munn *v.* The Commission Co., 15 Johns. R. 44, it was held that a corporation of limited powers might engage to pay or advance money at a future day by the acceptanee of a bill of exchange. In Mott *v.* Hicks, 1 Cowen, 513, it was held that a private corporation might give a negotiable promissory note for a debt incurred in its ordinary business. In Kelley *v.* Mayor of Brooklyn, 4 Hill, 263, it was held that a municipal corporation may issue negotiable paper for a debt contracted in the course of its proper business; and in delivering the opinion of the court COWEN, J., said: "Independently of any statute provision, a corporation may issue negotiable paper for a debt contracted in the course of its proper business. This is a power incident to all corporations, and no provision in its charter, or elsewhere, merely directing a certain form in affirmative words should be so construed as to take away the power. The same general principle will be found in Moss *v.* Oakley, 2 Hill, 265; Barker *v.* The Mechanic Ins. Co., 3 Wend. 96; Furniss *v.* Gilchrist, 1 Sandf. Sup. Ct. R. 53; Angell & Ames on Corp. § 257; Pierce on Railroads, 372. The result of the authorities, to adopt the language of a recent writer, seems to be that corporations carrying on business under no restraining act may make promissory notes and draw bills of exchange, where these are the usual and proper means to accomplish the purposes of their organization; that such notes and bills are to be presumed legal and valid where they are not prohibited by law and are received in good faith, and that they are invalid when given in violation of law, or when given for purposes wholly foreign to those for which the incorporation was created."

[1] McLane, Trustee, *v.* Placerville & Sacramento Valley R. R. Co., (1885) 66 Cal. 606; citing Commonwealth *v.* Smith, 10 Allen, 448; Comrs. of Craven *v.* Atlantic & N. C. R. R. Co., 77 N. C. 289; Miller *v.* New York & Erie R. R. Co., 18 How. Pr. 374; Dana *v.* Bank of United States, 5 Watts & S. 223.

[2] MITCHELL, J., in Wright *v.* Hughes, (1889) 119 Ind. 324; s. c., 21 N. E. Rep. 907; New England, etc., Ins. Co. *v.* Robinson, 25 Ind. 536; Jones *v.* Guaranty, etc., Co., 101 U. S. 622; Reichwald *v.* Commercial Hotel Co., 106 Ill. 439; Booth *v.*

§ 84. Evidences of indebtedness — form. — At common law a corporation has power to issue a bond or note to pay a debt.[1] The weight of modern authority supports the conclusion that private corporations, organized for pecuniary profit, may, like individuals, borrow money whenever the nature of their business renders it proper or expedient that they shall do so, subject only to such express limitations as are imposed by their charter. The power to borrow carries with it, by implication, unless restrained by the charter, the power to secure the loan by mortgage. Accordingly, it may be regarded as settled, that where general authority is given a corporation to engage in business, and there are no special restraints in its charter, it takes the power as a natural person enjoys it, with all its incidents and accessories; it may borrow money to attain its legitimate objects, precisely as an individual, and bind itself by any form of obligation not forbidden.[2] Unless restrained by legislative enactment

to a specific mode of contracting, the contracts a corporation has capacity to make may be made in that manner or form in which a similar contract by an individual could be made.[1] A private corporation, authorized to "borrow money and issue their bonds therefor," may bind itself by simple as well as by sealed contracts.[2]

§ 85. More rules on this subject.—There is a capacity in a corporation to enter into any obligation or make any contract essential for its purposes and for the transaction of its ordinary affairs. Such a power to contract existing, the power may be exercised by the corporation or its proper officers as a natural person can contract unless its charter presents some particular mode of contracting.[3] Promissory notes may be given by trading corporations for any indebtedness contracted within the scope of their powers, and it may *prima facie* be presumed that any notes given by them are for an indebtedness within the scope of their powers.[1] The power of a corporation to create debts and to make promissory notes is an incident to the power conferred by statute of California "to make by-laws, * * * for the organization of the company, the management of its property, the regulation of its affairs, the transfer of its stock and for carrying on all kinds of business within the objects and purposes of the company."[2] The provision of the statute of California that "no corporation created or to be created shall by any implication or construction be deemed to possess the power of issuing bills, notes or other evidences of debt upon loans or for circulation as money" has been construed not to prohibit the borrowing of money by corporations and issuing the usual evidences of debt therefor.[3] The constitutional provision of California forbidding, except on certain conditions, the increase by corporations of their bonded indebtedness has been held not to forbid the execution of non-negotiable notes and mortgages by a corporation in consideration of the promise by the payee of the notes and mortgages to advance money and deliver lumber as needed by the corporation for improvement of the mortgaged property.[4] A building association, the charter of which vests it with such power as to enable it to borrow money and to make loans to its members with a view to accomplish the purpose of its formation, may employ the usual legal methods of effecting this purpose, subject to such restrictions as that it shall not issue paper currency, for instance. And, having the right to effect a loan, it, through its officers, in their discretion, may give a promissory note for the purpose, and it may issue such a note for an intended indebtedness.[5] It is competent for any manufacturing corporation organized under the general laws of Minnesota to execute promissory notes as evidence of the debts it may lawfully contract.[6] As

Robinson, 55 Md. 419; Hays *v.* Galion Gas Light Co., 29 Ohio St. 330; Memphis, etc., R. R. Co. *v.* Dow, 19 Fed. Rep. 388; Green's Brice's Ultra Vires, 223; 1 Moraw. on Corp. §§ 342, 343.

[1] Trustees of University *v.* Moody, (1878) 62 Ala. 389. BRICKELL, Ch. J. said: "The technical rule of the ancient common law, that a corporation could not manifest its intentions by any personal act or oral discourse, and that it spoke and acted only by its common seal, if it ever obtained in this country, is now obsolete."

[2] McCullough *v.* Talladega Insurance Co., (1871) 46 Ala. 376; Bank of Columbia *v.* Patterson, 7 Cranch, 299; Talladega Ins. Co. *v.* Landers, 43 Ala. 115. That corporations may contract, as individuals do, in matters pertaining to their business, see Smead *v.* Indianapolis, etc., R. R. Co., 11 Ind. 104; Talman *v.* Rochester City Bank, 18 Barb. 123. As to the power of a corporation expressly or impliedly authorized to borrow money being exercised by issuance of negotiable bonds, see Des Moines Gas Co. *v.* West, (1878) 50 Iowa, 16. For rules in English cases as to liability of corporations upon contracts not under seal, see Arnold *v.* Mayor of Poole, 2 Dowl. (N. S.) 574; Bowen *v.* Morris, 2 Taunt. 374; Paine *v.* Guardians of Strand Union, 8 Q. B. 326; Cox *v.* Midland Counties Railway Co., 3 Exch. 268; Lamprell *v.* Billericay, 3 Exch. 306. How far they confine liability on promissory notes and bills of exchange to trading corporations only, see Mayor of Ludlow *v.* Charlton, 6 Mees. & W. 815; Murray *v.* East India Co., 5 B. & Ald. 204; Broughton *v.* Manchester W. Wks., 3 Barnw. & Ald. 1; Beverley *v.* Lincoln Gas Co., 6 Ad. & E. 829: Rew *v.* Pettet, 1 A. & El. 196; Church *v.* Imp. Gas Light Co., 6 Ad. & E. 846.

[3] McKiernan *v.* Lenzen, (1880) 56 Cal. 61. As to what officers of a corporation may do in connection with the affairs of a corporation, see Gillett *v.* Campbell, 1 Denio, 520, 522; Carey *v.* Giles, 10 Ga. 10; Phillips *v.* Campbell, 43 N. Y. 271. As to what a general manager cannot do, see Stow *v.* Wyse, 7 Conn. 219; Hawtayne *v.* Bourne, 7 Mees. & W. 595; Life & Fire Ins. Co. *v.* Mechanic Fire Ins. Co., 7 Wend. 31; Knight *v.* Lang, 4 E D. Smith, 381; Benedict *v.* Lansing, 5 Denio, 283; Torrey *v.* Dustin Monument Association, 5 Allen, 327, 329;

Despatch Line of Packets *v.* Bellamy Manufacturing Co., 12 N. H. 205, 228; Luse *v.* Isthmus Transit Ry. Co., 6 Oreg. 125.

[1] Gebhard *v.* Eastman, 7 Minn. 56.

[2] Smith *v.* Eureka Flour Mills Co., (1856) 6 Cal. 1.

[3] Magee *v.* Mokelumne Hill Canal & Mining Co., (1855) 5 Cal. 258.

[4] Underhill *v.* Santa Barbara Land, Building & Imp. Co., 93 Cal. 300; s. c., 28 Pac. Rep. 1049.

[5] Davis *v.* West Saratoga Building Union, (1869) 32 Md. 285.

[6] Sullivan *v.* Murphy, 23 Minn. 6. In Bacon *v.* Mississippi Insurance Co., 2 George (Miss.), 116, the Supreme Court of Mississippi held that a corpora-

under our general credit system, and the manner and modes of doing business, the success and prosperity of manufacturing corporations and other enterprises of like character would be greatly impeded and embarrassed, if not utterly destroyed, without the capacity and power to contract debts, borrow money and make and receive bills of exchange and promissory notes, these powers will be inferred where there are no prohibitions to the contrary in their charters.[1] A manufacturing corporation, declared by general law for the incorporation of such an one, "capable of buying, purchasing, holding and conveying any lands or tenements, hereditaments, goods, wares and merchandise whatever, necessary to enable [it] to carry on their manufacturing operations * * * ," has power to execute its promissory notes upon the purchase of such personal property or in liquidating the claims of its employees in its legitimate transactions. It also possesses power to borrow money for the same purposes and to bind itself in its corporate capacity by a written obligation for its payment.[2] A corporation authorized to construct a building for its use and purposes may accept an order drawn upon it by a materialman for material furnished and payable out of money due such materialman.[3] There can be no recovery on a note given by a corporation on a contract beyond the scope of its power.[4] A corporation being authorized by its charter to incur indebtedness and give evidence thereof, one dealing in its securities may, in the absence of notice to the contrary, assume that restrictions upon its power have not been violated.[5] A corporation may make a promissory note for a debt contracted in the course of its legitimate business, although not specifically authorized by its charter to contract in that form.[1]

§ 86. **Bonds of a banking association.**— In a case before the Court of Appeals of New York, the court held certain evidences of debt, called bonds, payable at different periods, issued by this banking association, intended for sale in London, to raise money for the uses of the association, bearing interest payable semi-annually in London, not naming the place for the payment of the principal, with the corporate seal impressed upon each bond, but without the use of wax or other tenacious substance, not to be within the prohibition of the restraining laws, and to be valid securities for the money loaned thereon, even if regarded as unsealed obligations, and, therefore, in legal effect, mere promissory notes.[2]

tion having power to loan money on bottomry, *respondentia*, etc., had no power to borrow money, and *prima facie* no power to make a promissory note. As to making promissory notes by private corporations in the course of their legitimate business, see Brode *v.* Firemen's Insurance Co., 8 Rob. (La.) 244; Louisiana State Bank *v.* Orleans Navigation Co., 3 La. Ann. 294.

[1] Oxford Iron Co. *v.* Spradley, (1871) 46 Ala. 98; New York Firemen Ins. Co. *v.* Sturges, 2 Cowen, 664.

[2] Mead *v.* Keeler, (1857) 24 Barb. 20. It was further said by the court: "It is to be presumed that [corporations] will conduct their operations in detail substantially upon the same principles and in the same manner as individuals engaged in like business. And when they do so, and confine themselves to the purposes and objects of their incorporation, they should not be deemed as transcending their authority, but should be regarded as acting within the scope of those implied incidental powers necessary to the full and advantageous development of those which are expressly given."

[3] Board of Trustees of Prairie Lodge *v.* Smith, (1880) 58 Miss. 301.

[4] Pearce *v.* Madison R. R., 21 How. 441.

[5] National Park Bank *v.* German-American Warehousing, etc., Co., (1886) 53 N. Y. Super. Ct. 367; following Ellsworth *v.* St. Louis, Alton & Terre Haute R. R. Co., 98 N. Y. 553.

[1] Moss *v.* Oakley, (1842) 2 Hill, 265; citing Mott *v.* Hicks, 1 Cow. 513; Barker *v.* Mechanic Fire Ins. Co., 3 Wend. 94. Later, in a case in the Chancery Court of New York, Attorney-General *v.* Life & Fire Insurance Co., (1842) 9 Paige, 470, the chancellor, WALWORTH, held that a corporation which was not prohibited by law from doing so, and without any express power in its charter for that purpose, might make a negotiable promissory note, payable either at a future day or upon demand, where such note was in fact made or given for any of the legitimate purposes for which the company was incorporated. He further held that where such notes have been issued and put in circulation in violation of a restraining law, it seems the holder is bound to show that he received them in the ordinary course of business and paid a valuable consideration for them, without notice of the illegal object for which they were issued, to entitle him to recover thereon as a *bona fide* holder.

[2] Curtis *v.* Leavitt, (1857) 15 N. Y. 9. Speaking as to the power of corporations to issue such paper, COMSTOCK, J., in his opinion, on page 66, said: "The right of corporations in general to give a note, bond or other engagement to pay a debt is so nearly identical, or so inseparably connected with the right to contract the debt that no doubt upon the question ought to be admitted. When a corporation can lawfully purchase property or procure money on loan in the course of its business, the seller or the lender may exact, and the purchaser or borrower must have the power to give, any known assurance, which does not fall within the prohibition, express or implied, of some statute. The particular restriction must be sought for in the charter of the corporation, or in some other statute binding upon it; but if not found in that examination, we may safely affirm that it has no existence. This doctrine would seem to be clear in principle, and it is well settled in this state. Mott *v.* Hicks, 1 Cow. 513; Barker *v.* Mechanic Ins. Co., 3 Wend. 96; Jackson *v.* Brown, 5 Wend. 590; Moss *v.* Oakley, 2 Hill, 265; At-

§ 87. Power to secure their indebtedness.— It is now well settled that corporations, like individuals, may borrow money for the conduct of their affairs, without express authority therefor, whenever the nature of their business may render it proper or expedient. And the power to borrow carries with it very generally, unless expressly restrained, the power to secure the loan by mortgage.[1] Having negotiated a loan for the advancement of its best interests, a corporation may pledge, as security for the loan, unissued stock held by it in trust.[2] The power to sell such securities for the payment of its debts, includes the power of the corporation to pledge securities owned by it for the same purpose.[3] The securities of a corporation may be lawfully pledged by the directors of a solvent corporation to secure individual demands of directors and others, due or to accrue, for money loaned to the corporation.[4]

§ 88. Limitation of indebtedness.— A limitation by statute of the amount of debts of a corporation includes indebtedness to the directors as well as indebtedness to third parties.[5] In a case

torney-General *v.* Life & Fire Ins. Co., 9 Paige, 470; Safford *v.* Wyckoff, 4 Hill, 442; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280. It would be a very illogical conclusion to hold that an indefinite number of corporations, authorized by a general law, do not possess the same right in this respect, which they would have if the express powers of each were derived from a special charter."

[1] Booth *v.* Robinson, (1880) 55 Md. 419; Susquehanna Bridge Co. *v.* Insurance Co., 3 Md. 305; Australian Steamship Co. *v.* Mounsey, 4 K. & J. 733; Curtis *v.* Leavitt, 15 N. Y. 9; Beers *v.* Phœnix Glass Co., 14 Barb. 358; Mead *v.* Keeler, 24 Barb. 20; Partridge *v* Badger, 25 Barb. 146; Clark *v.* Titcomb, 42 Barb. 122; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280; Life Insurance Co. *v.* Mechanic Ins. Co., 7 Wend. 31; Barnes *v.* Ontario Bank, 19 N. Y. 152; Smith *v.* Law, 21 N. Y. 296; Nelson *v.* Eaton, 26 N. Y. 410; Holbrook *v.* Basset, 5 Bosw. 147; Lucas *v.* Pitney, 27 N. J. Law, 221; Hackettstown *v.* Swackhamer, 37 N. J. Law, 191; Ridgway *v.* Farmers' Bank, 12 Serg. & R. 256; Oxford Iron Co. *v.* Spradley, 46 Ala. 98; Ala. Gold Life Ins. Co. *v.* Central, etc., Assn., 54 Ala. 73; Union Bank *v.* Jacobs, 6 Humph. 515; Moss *v.* Harpeth Academy, 7 Heisk. 283; Commercial Bank *v.* Newport Mfg. Co., 1 B. Mon. 14; Bank of Chillicothe *v.* Chillicothe, 7 Ohio, pt. 2, 31; Hamilton *v.* Newcastle R. R. Co., 9 Ind. 359; Rockwell *v.* Elkhorn Bank, 13 Wis. 653; Thompson *v.* Lambert, 44 Iowa, 239; Bradley *v.* Ballard, 55 Ill. 413; Gause *v.* City of Clarksville, 7 Rep. 519; Union Mining Co. *v.* Rocky Mountain Nat. Bank, 2 Colo. 248; Magee *v.* Mokelumne Hill Canal Co., 5 Cal. 258.

[2] Combination Trust Co. *v.* Weed, 2 Fed. Rep. 24.

[3] Leo *v.* Union Pac. Ry. Co., 17 Fed. Rep. 273.

[4] Stout *v.* Yaeger Milling Co., 13 Fed. Rep. 802.

[5] Tallmadge *v.* Fishkill Iron Co., 4 Barb. 382.

before the Court of Common Pleas of New York city, it has been held that where a corporation adopted a by-law providing that all contracts by it involving a liability for $500 or more must be in writing, executed by both the president and treasurer, and attested by the seal of the company, the company cannot be held liable on a lease to it reserving a rent exceeding $500, and executed by the president alone, without the seal of the company; and this whether the lessor had notice of the by-law or not.[1] And in such case, no ratification could be based on the treasurer's knowledge of the facts where his testimony that he refused to sign the lease was wholly uncontradicted.[2] The Kansas Supreme Court has held that a private corporation organized under the statute of that state was bound by a contract within the scope of its business, by which an indebtedness greater than $500 was incurred, notwithstanding a provision in its charter that its indebtedness should not exceed $500, as this provision was merely directory, and the statute under which it was organized did not require its indebtedness to have any limit other than the amount of its capital stock.[3]

§ 89. Debt limited by par value of capital stock.— A street railway company, a Pennsylvania corporation, was authorized by its charter to borrow money not exceeding in amount "one-half of the par value of the capital stock." The capital authorized in the act of the legislature granting its charter was $1,000,000. Only ten per cent, or $100,000, of the authorized amount was paid in. The directory of the company by resolution authorized an issue of bonds, to be secured by mortgage to the amount of

[1] Bohm *v.* V. Loewer's Gambrinus Brewery Co., (1890) 16 Daly, 80; s. c., 9 N. Y. Supp. 514, following Rathburn *v.* Snow, 3 N. Y. Supp. 925. See, also, Westerfield *v.* Radde, 7 Daly, 326.

[2] Bohm *v.* V. Loewer's Gambrinus Brewery Co., (1890) 16 Daly, 80; s. c., 9 N. Y. Supp. 514. Bischoff, J., said: "An attempt was made by the plaintiff, upon the trial, to show a subsequent adoption or ratification of the president's act by the trustees, predicated upon the neglect of the trustees to repudiate the transaction when it was brought to their notice. * * * The trustees * * * as such, could not, pursuant to the provisions of the by-laws mentioned, have originally created any liability on behalf of the corporation exceeding five hundred dollars in amount; and it cannot be said that they can by implication do the acts prohibited in unequivocal terms. Peterson *v.* Mayor, etc., 17 N. Y. 449; Brady *v.* Mayor, etc., 20 N. Y. 312-319."

[3] Sherman Center Town Company *v.* Morris, 43 Kans. 282; s. c., 23 Pac. Rep. 569.

$250,000. A bill in equity having been filed by the commonwealth to restrain by injunction the issue of these bonds to the extent proposed, an injunction was decreed, from which an appeal was entered to the Supreme Court of the state. Before the latter the contention of the company was that the grant of power in their charter authorized an issue of bonds for the purpose of borrowing money to the amount of one-half of their authorized capital. The Supreme Court held adversely to this contention, and sustained the decree of the court which enjoined an issue of the bonds beyond the amount of $50,000, one-half of the amount of the stock actually paid in.[1]

[1] Commonwealth *v.* Lehigh Ave. Ry. Co., (1889) 129 Pa. St. 405; s. c., 18 Atl. Rep. 414, 498; 7 Ry. & Corp. L. J. 42. WILLIAMS, J., for the court, upon the question of what constitutes the capital stock of a corporation and its par value, discusses the question, quite *in extenso* as follows: "The words stock and capital stock may be defined as meaning the fund or property belonging to a firm or corporation, and used to carry on its business. This is contributed by those who embark in the business. The articles of copartnership, or the charter of the corporation, fix the maximum amount of stock that may be issued, and this may properly be spoken of as the proposed or authorized capital of the company. When an organization is effected, subscriptions are made to the stock, by which the subscribers agree to take and pay for certain sums or shares each. The total amount of the stock thus taken constitutes the subscribed capital of the company. Some of these subscriptions may not be paid and may be uncollectible, but when the amount subscribed, or called for upon subscriptions, has been collected, so far as collection is practicable, the amount so gathered into the treasury constitutes the actual capital on which the business is undertaken. The amount paid by each subscriber measures his relative interest in the whole. As between himself and the corporation, or his fellow-subscribers, or the public, his share of the whole stock is fixed by the proportion which his actual contribution bears to the entire amount contributed by all who are associated in the enterprise. * * * Does the corporation stand on better ground than its members? It claims the right to issue bonds because of its stock. We must inquire, therefore, first, what is the amount of its stock? And, next, what is the par value of a share of that stock? We think the first of these questions is, in the light of the facts in this case, answered by repeated decisions of this court. Whether it be for the purpose of adjusting and paying dividends to stockholders, or of regulating the amount of taxes due to municipalities having the right and power to tax the amounts of stock actually paid is the capital stock of the company. Citizens' Pass. Ry. Co. *v.* Philadelphia, 49 Pa. St. 251. Neither the cost of the road, nor the authorized capital can be made the basis of dividends or taxation, but these must rest on the amount of capital stock actually paid in. Second & Third St. Pass. Ry. Co. *v.* Philadelphia, 51 Pa. St. 465; Philadelphia *v.* Philadelphia & Gray's Ferry Pass. Ry. Co., 52 Pa. St. 177; Philadelphia *v.* Ridge Avenue Ry. Co., 102 Pa. St. 190. The company appellant proposes to exercise a power and incur a liability upon the basis of its capital stock, and for this purpose, as for purposes of taxation or payment of dividends, its rights must be measured not by nominal or authorized capital, but by the actual amount of capital paid in. The issuing of certificates of stock to the subscribers does not add to the common stock in the treasury or business of the corporation, nor does it increase the interest of the individual stockholder. He takes this certificate when issued, subject to all the unpaid installments of the subscription and the terms and conditions on which the subscription was made. Its value to him, as between him and the corporation, is what he has paid upon it; no more, no less. That value may be increased or diminished in a commercial sense by the success of the business, the ability of the management, or other similar consideration, and such increase or decrease makes the market value greater or less than the amount he has paid upon it, as the case may be; but as between himself and the corporation or his fellow-stockholders the consideration of market value has no place. He must pay his subscription as calls are made whether the venture prospers or fails. If the value of the stock is measured by what has been paid upon it, is the 'par value' measured in the same manner when the right of the corporation to do a given act is to be settled? The par value of the stock of this corporation for purposes of taxation or payment of dividends, is, as we have already seen, the amount actually paid upon it, or one hundred thousand dollars, This is well settled by the cases we have cited, which hold that, for the purposes enumerated, the par value has no necessary relation to either the authorized or the market values, but is fixed by the amount actually paid, and is the equivalent or par of the value of the shares as shown by the stock account. The issuing of certificates does not affect our question. If issued they cannot increase the money in the treasury, or confer any independent right on the stockholder. They simply afford evidence of the extent of his interest in a more convenient form than the books of the company furnish, but leave him subject to all the liabilities resting on him before they come into his hands. We see no good reason for distinguishing this case from the cases cited above, but regard it as substantially ruled by them. The [corporation here] has received just one hundred thousand dollars from the subscribers to its stock. So far as the paper books advise us, this is all it has ever asked for in the more than fifteen years of its corporate life, and all it expects to receive. The other nine hundred thousand dollars of authorized capital are uncalled and unpaid. The par value of all its shares taken together is one hundred thousand dollars, because that is the sum paid upon them, the value they represent. The par value of each share is fixed in like manner. Its value is the equal, or par, of the corporate capital it represents, which is the amount paid upon by the subscriber or applied to it out of the earnings of the corporation. * * * We have the fact on the record that but one-tenth of the nominal value [of the stock] has been paid. The corporation is the party. It has one hun-

§ 90. When a statutory limitation of indebtedness does not apply.— In a Minnesota case where the corporation, a milling company organized under the general statute of that state,

one of the original articles of incorporation of which provided that "the highest amount of indebtedness or liability to which said corporation shall be subject shall not exceed $5,000," was sued upon a promissory note issued by it in payment of a balance upon settlement of an account, to one who was an officer of the company and a member of a banking firm through which the financial business of the corporation was largely done, and by him transferred before maturity to the bringer of this action, the corporation made the defense that the giving of the promissory note was *ultra vires*. The Supreme Court affirmed the order of the trial court giving judgment in favor of the plaintiff.[1]

dred thousand dollars in its treasury and no more; yet it asks us to hold that the par value of its stock is one million dollars, and permit it to exercise an important power on that basis. This we decline to do. The par value of its shares is measured by the money it has received upon them, and not by the broken promises of those who subscribed for them."

[1] Auerbach *v.* Le Sueur Mill Co., (1881) 28 Minn. 291; s. c., 9 N. W. Rep. 799. Reasoning in support of their judgment, the court said: "Where a private corporation has authority to issue negotiable securities, such instruments, when issued, possess the legal character ordinarily attaching to negotiable paper, and the holder in good faith before maturity, and for value, may recover, even though, in the particular case, the power of the corporation was irregularly exercised or was exceeded; or, to state the legal proposition in its application to this case, this defendant having power to incur debts to a limited extent and to issue its negotiable notes therefor, the plaintiff, as a *bona fide* holder of the note in suit, may recover upon it, although, in this particular case, the indebtedness of the corporation at the time of giving this note already exceeded the limits prescribed by its articles of association. Stoney *v.* American Life Ins. Co., 11 Paige, 635; Mechanics' Banking Assn. *v.* New York & Saugerties White Lead Co., 35 N. Y. 505; McIntire *v.* Preston, 10 Ill. 48; Monument Nat. Bank *v.* Globe Works, 101 Mass. 57; Bissell *v.* Mich. Southern & Northern Ind. R. Co., 22 N. Y. 258, 289; City of Lexington *v.* Butler, 14 Wall 282; Moran *v.* Miami County, 2 Black, 722; Angell & Ames on Corp. § 268; Field on Corp. 303; Green's Brice's Ultra Vires, 273, 274, 729. Although in such a case the corporation or its officers exceeded the corporate authority, and its contract would be, hence, in a sense, *ultra vires*, yet other legal principles, besides those merely relating to the powers of the corporation, come in to affect the result. It is true, a corporation is a being created by the law, and has properly no authority but such as is conferred upon it, expressly or by implication, by the law of its creation; yet it may become legally bound to observe and perform contracts which it had not authority to enter into. The ends of justice may require, as in this case, that the corporation which has exceeded its powers should be estopped by its own acts from pleading, in defense of its assumed obligations, that they were *ultra vires*. "To apply the principle of estoppel is not to enlarge the powers of the corporation; nor does it give warrant to a corporation to disregard or violate the restrictions which have been expressly imposed upon it, or which exist in the absence of power conferred. It was said by the court in Bradley *v.* Ballard, 55 Ill. 413: 'This doctrine [estoppel] is applied only for the purpose of compelling corporations to be honest, in the simplest and commonest sense of honesty, and after whatever mischief may belong to the performance of an act *ultra vires* has been acomplished.' In Railway Co. *v.* McCarthy, 96 U. S. 258, the court say: 'The doctrine of *ultra vires*, when invoked for or against a corporation, should not be allowed to prevail where it would defeat the ends of justice or work a legal wrong.' Whether the plea of *ultra vires* should be allowed as a defense to assumed obligations should not be determined without regard to the character and objects of the corporation, the nature of the powers conferred or withheld, the particular character of the obligations assumed on contract entered into, the relations of the contracting parties, and the *bona fides* of him against whom the doctrine of *ultra vires* is asserted. In this case the defense sought to be made to the note is that in giving it the article of the defendant's incorporation, limiting the amount of its indebtedness, was violated. The debt was incurred in the ordinary prosecution of the business of the corporation. The defendant received and appropriated the money which was the consideration of the note, and having authority to issue negotiable paper, it put forth the note in question, negotiable, calculated to circulate as, and perform the office of, commercial paper, and expressing upon its face the obligation and promise of the maker to pay the bearer, at all events, the sum named. It has come into the hands of a *bona fide* purchaser, and simple justice, as well as plain principles of law, forbid that courts should listen to the plea that in this particular case the corporation had not authority to issue its note. It ought to be and is estopped. To so hold does not weaken the sanction of the law which restrains the exercise of corporate power within the limits prescribed by the creative act. To refuse to recognize and enforce, when necessary to the attainment of justice and prevention of wrong, such contracts, made in violation of the corporate charter, is not to afford a remedy for the wrongful acts of the corporation. When, in a case like this, the unauthorized contract has been executed by the corporation, and it has reaped the benefits of it, public policy does not require the courts to refuse to administer justice between the parties in accordance with the plain principles of law. In such a case, the remedy for the violation by the corporation of its charter power lies elsewhere. We are here seeking to administer justice as between these contracting parties. If justice did not invoke the application of other principles of law, the defense of *ultra vires* might be sufficient; but the doctrine of estoppel, as a principle of law, is as positive and well recognized as is the law that a corporation may not exceed its corporate powers, and although the defendant exceeded its authority, it should be denied the right to assert the fact of its own wrong, when to allow its plea would work injustice and wrong to him who has been misled by its acts, performed within the general scope of its powers. What has been said should be regarded only as said with reference to this case, and should not be considered as stating a rule of law which should prevail generally in the case of contracts not negotiable."

CHAPTER III.

POWER OF AGENTS AND OFFICERS — PUBLIC CORPORATIONS.

§ 91. General rules.
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§ 91. General rules.— Municipal officers have no general authority to bind the corporation. Their authority as agents is special.[1] The contracts of such officers, entered into with its knowledge, though not expressly authorized, will bind the corporation.[2] In like manner as individual and private corporations, municipal or public corporations may make contracts through their officers or agents, appointed properly for the purpose, in all matters that appertain to the corporation. And such contracts may be by parol.[3] Parol contracts made by authorized agents of a municipal corporation, within the scope of its purposes, are express promises of the corporation.[4] But contracts not within

[1] Ross *v.* City of Philadelphia, 115 Pa. St. 222; s. c., 8 Atl. Rep. 398.

[2] Allegheny City *v.* McClurkan, 14 Pa. St. 81.

[3] Duncombe *v.* City of Fort Dodge, (1874) 38 Iowa, 281; City of Indianola *v.* Jones, 29 Iowa, 282.

[4] San Antonio *v.* Lewis, 9 Tex. 69.

the scope of their authority are not enforceable against the corporation.[1] For instance, under the ordinances of a Maryland city, as appeared in this case, the city commissioner could make contracts for grading and paving, and assess taxes for the same in two classes of cases, to wit: (1) Upon application of the proprietors of a majority of front feet, where the street had been condemned; and (2) upon the like application of all the proprietors of ground fronting on the street, where it had not been officially condemned. The Court of Appeals held that without such an application the city commissioner was entirely destitute of the official character and power, in and by which alone he could take any legal proceeding or make any valid contract for grading and paving, and the power of the mayor to approve of his determinations to grade and pave, and of his contracts for the same was limited likewise and controlled by the same conditions; therefore, it followed that a contract made by the city commissioner for grading and paving a street not formally condemned, upon the application of the owners of a majority of feet fronting on it, and not of all the proprietors of ground on it, was an invalid contract, and not binding on the city.[2] The government or other public authority of a municipality will not be bound by acts of public agents, unless it manifestly appears that the agent is acting within the scope of his authority, or he has been held out as having authority to do the act, or has been employed in his

[1] Addis *v.* City, 85 Pa. St. 379; Wahl *v.* Milwaukee, 23 Wis. 272.

[2] Mayor & City Council of Baltimore *v.* Eschbach, (1861) 18 Md. 276. In this case the Court of Appeals of that state have expressed themselves fully upon the principles governing the contracts of public agents in these words: "The fact that the contract made related to a subject within the scope of his powers, does not make it obligatory on the [municipality] if there was a want of specific power to make it. Although a private agent, acting in violation of specific instructions, yet within the scope of a general authority, may bind his principal, the rule as to the effect of a like act of a public agent is otherwise. The city commissioner, upon whose determination to grade and pave the contract was made, was the public agent of a municipal corporation, clothed with duties and powers especially defined and limited by ordinances bearing the character and force of public laws, ignorance of which can be presumed in favor of no one dealing with him in matters thus conditionally within his official discretion. For this reason the law makes no distinction between the effect of the acts of an officer of a corporation and those of an agent for a principal in common cases. In the latter the extent of authority is necessarily known only to the principal and agent, while in the former it is a matter of record in the books of the corporation or of public law."

capacity as a public agent to make the declaration or representation for the government.[1]

§ 92. **More general rules.**— The legislature of a state investing a public corporation with the power to do certain acts, the governing board of the corporation will have an implied right to use the fit and appropriate means. For instance, where the County Court of a county under the authority conferred upon it to subscribe to the stock of a railroad corporation may make an order for the subscription, they may subsequently make an order appointing an agent to enter the subscription upon the books of the railroad corporation as a proper method for completing the subscription.[2] Where a city has lawful authority, say to construct sidewalks, involved in this authority would be the right to direct the mayor, and the chairman of the committee on streets and alleys, to make a contract on behalf of the city for doing the work.[3] So a municipal corporation, a city, may employ a third person, not an officer or regularly constituted agent, to negotiate for it in procuring a right of way for a ditch, for instance.[4] It is well settled that public officers or agents are held more strictly within the limits of their prescribed powers than private general agents — not only because the extent of their power is more easily seen, but because the rights of large communities are in greater need of diligent guards than those of individuals, whose

[1] Mayor & City Council of Baltimore *v.* Reynolds, (1863) 20 Md. 1. It was said by the court: "Cities and other purely municipal corporations or bodies politic which are allowed to assume some of the duties of the state, in a partial or detailed form, having neither property nor power for the purposes of personal aggrandizement, can be considered in no other light than as auxiliaries of the government, and as secondary and deputy trustees and servants of the people. McKim *v.* Odom, 3 Bland Ch. (Md.) 417; Ang. & Ames on Corp. 11. Agents themselves, not principals, answerable to their constituents, they are not to be presumed to recognize and individually ratify and confirm the acts of their officers, done beyond the scope of their authority. Acts of ratification by such bodies politic should be direct, explicit, unequivocal, with full knowledge of the facts."

[2] Hannibal & St. Joseph R. R. Co. *v.* Marion County, (1865) 36 Mo. 294. The court said: "The County Court * * * has the control and management of the property, real and personal, of the county. It is the agent of the county, and may lawfully and of right do whatever is necessary to carry out and execute the trusts reposed in it."

[3] Hitchcock *v.* Galveston, (1877) 96 U. S. 341.

[4] Stewart *v.* City of Council Bluffs, (1882) 58 Iowa, 642.

selfishness is quite apt to hold in frequent review the acts of all employees.[1] It is well settled that the fact that the contract made by a public agent, related to a subject within the general scope of his powers, does not bind his principal, if there was a want of specific power to make it. Although a private agent acting in violation of specific instructions, yet within the scope of his general authority, may bind his principal, the rule as to the effect of a like act of a public agent is otherwise.[2] From this it follows that one who contracts or deals with the agents or officers of a municipal or public corporation must, *at his peril*, take notice of the limits of their powers.[3] The United States Supreme Court has approved the rule as declared by Judge Dillon in his work on Municipal Corporations, section 283, in these words: "As a *general rule*, it may be stated that not only where the corporate power resides in a *select body*, as a city council, but where it has been delegated to a *committee* or *agents*, then, in the absence of special provisions otherwise, a *minority* of the select body or of the committee or agents, are powerless to bind the majority or do any valid act. If all the members of the select body or committee, or of all of the agents are assembled, or if *all* have been duly notified, and the minority refuse or neglect to meet with the others, a majority of those present may act, provided those present constitute a majority of the whole number. In other words, in such a case, a majority part of the whole is necessary to constitute a quorum, and a majority of the quorum may act. If the major part withdraw so as to leave no quorum, the power of the minority to act is, in general, considered to cease."[4]

[1] Parsel *v.* Barnes & Bro., (1868) 25 Ark. 261.

[2] Ibid. Mayor, etc., of Baltimore *v.* Reynolds, (1862) 20 Md. 1; Delafield *v.* State of Illinois, (1841) 26 Wend. 192.

[3] Mayor, etc., of Baltimore *v.* Musgrave, (1877) 48 Md. 272; State ex rel. Mayor, etc., *v.* Kirkley, 29 Md. 85; Horn *v.* Mayor, etc., 30 Md. 218. See, also, The Floyd Acceptances, (1868) 7 Wall. 666; Marsh *v.* Fulton County, (1870) 10 Wall. 676; Clark *v.* Des Moines, (1865) 19 Iowa, 199, 210; Treadwell *v.* Commissioners, (1860) 11 Ohio St. 183; Gould *v.* Sterling, 23 N. Y. 464; Starin *v.* Genoa, 23 N. Y. 439, 452; People *v.* Mead, 36 N. Y. 224; Dodge *v.* County of Platte, 82 N. Y. 218; United States *v.* City Bank of Columbus, (1858) 21 How. 356; DeVoss *v.* Richmond, (1868) 18 Gratt. (Va.) 339; Lewis *v.* Barbour Co. Comrs., 3 Fed. Rep. 191.

[4] Brown *v.* District of Columbia, (1888) 127 U. S. 579, 586. This rule is supported by the following cases: Day *v.* Green, (1849) 4 Cush. 433; Fisher *v.* Attleborough, (1849) 4 Cush. 494; Kingsbury *v.* School District, (1846) 12 Met. 99; Coffin *v.* Nantucket, (1850) 5 Cush. 269; Damon *v.* Granby,

§ 93. Illustrations of the duty and powers of municipal officers.— A city comptroller, being required to perform "such duties in relation to the finances" as "shall be prescribed by ordinance," would be authorized, upon an ordinance properly passed giving him the power, to negotiate and dispose of city bonds. It is his official duty, when such bonds are in his hands in shape to be negotiated, to keep them safely, until he lawfully disposes of them, and an unauthorized disposition of such bonds will subject him and sureties to liability upon his bond for the proceeds.[1] The common council of a city being given the power by its charter to audit and allow accounts, and the comptroller being only permitted by the charter to receive, examine and report upon them, the comptroller has no power to modify a contract on the part of the city.[2] A director of the poor appointed by the council of a city, his duties and powers being expressly such as officers of like kind in townships, has no power to bind the city by a contract with a surgeon to perform a surgical operation upon a pauper for a fixed sum.[3] A city charter providing that no moneys could be lawfully paid out of its treasury, except upon warrants regularly drawn according to the charter, its treasurer cannot justify any payments of moneys made by him otherwise, as to contractors, for instance, doing work for the city.[4] A mayor and council of a city have no authority to contract with a city treasurer that the latter may use the funds of the city and pay a percentage therefor; such a contract would be illegal and void, and would not authorize the treasurer to so use the funds.[5] A city cannot be made liable, by a resolution of the city aldermen, for the expense of defending contempt proceedings against its aldermen who have been convicted of contempt in disobeying an injunction, the conviction not having been reversed.[6] In entering into a contract for the grading of a street a street commissioner of a city has no power to contract, except according to

(1824) 2 Pick. 345, 355; State *v.* Jersey City, 27 N. J. Law, 493; Charles *v.* Hoboken, 27 N. J. Law, 203; Dey *v.* Jersey City, (1869) 19 N. J. Eq. 412; Mayor, etc., of Baltimore *v.* Poultney, (1866) 25 Md. 18.

[1] Stevenson *v.* Bay City, (1872) 26 Mich 44.

[2] Advertiser & Tribune Co. *v.* Detroit, 43 Mich. 116; s. c., 5 N. W. Rep. 72.

[3] Barber *v.* City of Saginaw, (1876) 34 Mich. 52.

[4] McCormick *v.* Bay City, (1871) 23 Mich. 457.

[5] Manley *v.* City of Atchison, (1872) 9 Kans. 358.

[6] West *v.* City of Utica, 71 Hun, 540; s. c., 24 N. Y. Supp. 1075.

the resolution of the common council directing the doing of the work under his direction, and the proposals and estimates received in pursuance of the advertisement of the same.[1] There being no limitation of the power of a city to make purchases for fitting up rooms for the use of city officers, and no particular manner for making contracts for such a purpose prescribed in its charter, the city council may confer the power on a committee, as the act to be performed would be a mere business act, and not of the class relating to the government of the city, which they could not delegate.[2] Where an order was given by a single member of a committee appointed by a city council to perform a business act, for work to be done and goods furnished, the New York Court of Appeals held that the city, having enjoyed the benefit of the same, was liable for the work and goods on a *quantum meruit*.[3] Under a city charter in California authorizing the library board "to control and order the expenditure of all moneys at any time in the library fund," and "generally to do all that may be necessary to carry out the spirit and intent of this charter in establishing a public library and reading room," the Supreme Court of that state has held that the library board might appropriate money to pay the expense of a delegate to a congress of librarians.[4]

§ 94. Ratification by municipal corporations of contracts made by their agents or officers.—A contract, neither immoral nor unlawful, entered into by an agent of a municipal corporation, and such as it might make itself, may be ratified by the corporation, as by an individual, either formally or by its conduct.[5] The contract of a municipal corporation, which is invalid when made, as in violation of some mandatory requirement of its charter, can be ratified only by an observance of the conditions essential to a valid agreement in the first instance.[6] But where the forms and conditions prescribed are not intended as a

[1] Bonesteel *v.* City of New York, (1860) 22 N. Y. 162, affirming Bonesteel *v.* City of New York, 6 Bosw. 550.

[2] Kramrath *v.* City of Albany, (1891) 127 N. Y. 575; s. c., 28 N. E. Rep. 400.

[3] Ibid.

[4] Kelso *v.* Teale, (Cal. 1895) 39 Pac. Rep. 948.

[5] City of Findlay *v.* Pertz, (U. S. C. C. A. 1895) 66 Fed. Rep. 427.

[6] Gutta-Percha & Rubber Manuf. Co. *v.* Village of Ogalalla, (Neb. 1894) 59 N. W. Rep. 513; citing Town of Durango *v.* Pennington, 8 Colo. 257; s. c., 7 Pac. Rep. 14; McCracken *v.* City of San Francisco, 16 Cal. 623; San Diego Water Co. *v.* City of San Diego, 59 Cal. 522; Cory *v.* Board, 44 N. J.

limitation upon the powers of the corporation, a compliance with such conditions is not essential to a binding ratification.[1] A corporation retaining and using money borrowed for it by its officer in excess of his authority ratifies the transaction and is liable.[2] A public corporation cannot, by subsequent ratification, make good an act of an agent which it could not have directly authorized.[3] A contract made in behalf of a municipal corporation, void in its inception from want of authority in the officer to make it, cannot be validated by the subsequent approval of the council.[4] A school district, by its action in completing a school building, left unfinished by an absconding contractor, by furnishing the building with desks, seats and other necessary schoolhouse furniture, by occupying the building for school purposes and insuring the

Law, 445; Keeney *v.* Jersey City, 47 N. J. Law, 449; s. c., 1 Atl. Rep. 511; Newman *v.* City of Emporia, 32 Kans. 456; s. c., 4 Pac. Rep. 815; McBrian *v.* Grand Rapids, 56 Mich. 103; s. c., 22 N. W. Rep. 206; McDonald *v.* Mayor, etc., 68 N. Y. 23; Smith *v.* City of Newburgh, 77 N. Y. 130; Bank *v.* South Hadley, 128 Mass. 503.

[1] Gutta-Percha & Rubber Manuf. Co. *v.* Village of Ogalalla, (Neb 1894) 59 N. W. Rep. 513. An action to recover the value of goods sold to the village.

[2] Willis *v.* St. Paul Sanitation Co., (1893) 53 Minn, 370; s. c., 55 N. W. Rep. 550. In White *v.* City of Rahway, 11 Fed. Rep. 853, it appearing that the treasurer of a city, under the board of finance, borrowed of a bank a sum of money and the city ratified the loan made by its agent by a renewal of the note from time to time, and by payments upon it at different times, and when the note was executed by the treasurer he pledged as security for its payment bonds of the city, subsequently substituting therefor other ten-year bonds of the city, and there remaining a sum due and unpaid upon the note, it was held in the federal court that under the laws of New Jersey the treasurer was authorized, under the board of finance, to make the loan, and that there could be a recovery upon the note without first disposing of the collaterals. As to what would show a valid contract by ratification on the part of the county, see Leon County *v.* Vann, (Tex. 1894) 27 S. W. Rep. 258.

[3] Hodges *v.* City of Buffalo, 2 Denio, 110; Halstead *v.* Mayor, etc., of New York, 3 N. Y. 430; Boom *v.* City of Utica, 2 Barb. 104; Cowen *v.* Village of West Troy, 43 Barb. 48. When a ratification will bind the corporation, see Peterson *v.* Mayor, etc., of New York, 17 N. Y. 449; People *v.* Flagg, 17 N. Y. 584; s. c., 16 How. Pr. 36. In Scott's Exrs. *v.* Shreveport, 20 Fed. Rep. 714, it was held that the agent of the city, having no authority to bind the city by giving a note, for lack of power in the city to raise money to donate to a railroad company, the obligation could not be made binding on the corporation by any subsequent act of the municipal authorities.

[4] Ruggles *v.* Collier, (1869) 43 Mo. 353. As to ratification of contract of an agent by a municipal corporation, see McCloskey *v.* City of Albany, 7 Hun, 472. Where it cannot be inferred, see Burns *v.* Mayor of New York, 5 T. & C. 371.

same, will ratify and make binding upon the district a contract for constructing the school building void because made by only one member of the school board.[1] So a school district which had received, retained and used for a long period of time school furniture bought for it by the members of the school district board, acting separately without any meeting of the board, has been held to have ratified the purchase and a recovery allowed upon the contract against the district.[2] he Appellate Court of Missouri has held that, as the board of directors of a school district can act only when assembled in a meeting as a board, and neither two nor all can bind the district by a contract, the fact that furniture purchased by them under a contract made outside of a board meeting had been placed in the schoolhouse and used would not amount to a ratification of this illegal contract.[3]

§ 95. Agents and officers of counties — generally. — The character of the agency which the officers of a county hold in connection with its financial affairs is well expressed and defined by the Iowa Supreme Court in an early case when the county judge was charged with the management of the affairs of a county in that state. They said: "The analogy between this officer and an agent will hold good but a little way. It does not hold good in any valuable sense. It is true that the statute in creating him styles him the general agent of the county. But this is not to institute this relation properly. It was to declare him to be the general rather than the special agent. At the best he is but a *quasi* agent. Properly speaking, he has no principal, and so far as he has, this principal only appoints him and has no further power over him. He does not derive his powers from the county but from the law, and the county cannot revoke them. It cannot act itself in any case. He is the head and hand of the county. In short, he is an officer of the law, deriving his powers from the law, and governed by it."[4] The governing boards of counties are known under different titles in the different states.

[1] School District No. 39 in Brown County *v.* Sullivan, (1892) 48 Kans. 624; s. c., 29 Pac. Rep. 1141.

[2] Union School Furniture Co. *v.* School District No. 60 of Elk County, (1893) 50 Kans. 727; s. c. 32 Pac. Rep. 368.

[3] Thomas Kane & Co. *v.* School Dist. of Calhoun, (1893) 48 Mo. App. 408.

[4] Clapp *v.* County of Cedar, (1857) 5 Iowa, 15, 55, a case involving the authority of a county judge in the issuance of county bonds in payment of a subscription to the stock of a railroad company.

County Courts in some, board of county commissioners in others; supervisors in some and boards of chosen freeholders in others, as well as other titles. We will give some illustrations in this chapter of the powers of these different officers in the financial management of the counties from different state decisions which may guide in determining the powers of similar officers in any other state. The County Court in Arkansas may levy a tax for the payment of a judgment recovered against a county for a valid debt evidenced by warrants duly issued by the county authorities.[1] In affirming an order for a peremptory writ of *mandamus* to compel a county treasurer to pay certain warrants issued by order of a board of county commissioners, the Colorado Court of Appeals has held that a county treasurer is not clothed with power to pass on the legality of the action of the governing body of the county. "Power to determine the validity of all claims," they said, is intrusted to the board. When they have audited and allowed a claim, and a warrant is issued in accordance with their determination, we cannot see that the statute has clothed the treasurer with the supervisory power to determine the validity of their acts.[2] County commissioners cannot legally transact county business except at a regular session of the county board or one specially called by the county clerk, of which notice is given in the mode provided by law.[3] The money in the hands of a county treasurer in Nebraska under the revenue bond road laws of that state, being held in trust by the treasurer for the road districts, the board of county commissioners have no authority

[1] Bush *v.* Wolf, (1891) 55 Ark. 124; s. c., 17 S. W. Rep. 709.

[2] Beeney, County Treasurer, *v.* Irwin, (Colo. App. 1895) 39 Pac. Rep. 900. Leading up to their conclusion, the court used this language: As we said in Commissioners *v.* Lee, 3 Colo. App. 177; s. c., 32 Pac. Rep. 841: "Under the statutory plan which divides the state into counties and regulates the government of those territorial subdivisions all power to fix, control, determine, or in any manner dispose of the funds of a county, is devolved on the board of county commissioners. They alone have the right to disburse the public moneys and to decide in what cases and under what circumstances such funds shall be paid out, unless it be in those cases where fixed rights are conferred by statute. In and of itself this fact should be decisive of the present inquiry. Wherever a broad, universal and sweeping power is thus given to a governing body it cannot be conceded that, by implication, any other body, whether it be a court or one resembling the board of county commissioners, should likewise have power to dispose of the public revenues."

[3] Morris *v.* Merrel, (Neb. 1895) 62 N. W. Rep. 865.

to draw warrants against such funds.[1] Under the New Jersey statutes in regard to such matters, a board of chosen freeholders are not empowered to make an excessive appropriation for some particular class of expenditures that it, with the surplus, may make up deficiencies in other classes of expenditures.[2] Under the statute of New Jersey, a board of chosen freeholders can improve any ordinary highway under their control only with money obtained from the sale of road bonds.[3] A county commissioners' court in Texas by electing, with knowledge of a contract of a county judge to purchase county bonds for the permanent school fund, to carry out its provisions and to hold the bonds, has been held to be a ratification of the contract.[4] The Washington Supreme Court has held that a board of county commissioners in that state, having power to contract for the services of a county physician, though their term of office be about to expire, may contract with a physician for one year extending into the term of office of their successors.[5] The different statutes of Utah, the one which empowers the County Court in Utah to lay out and maintain public roads and perform other acts from which indebtedness must arise; another which provides that no county shall incur any indebtedness or liability in any manner or for any purpose to an amount exceeding, etc.; another, that the County Court must not contract liabilities except in pursuance of law, and the one which provides that warrants drawn by order of such court must specify the liability for which they are drawn, have been held by the Supreme Court of that territory to confer by implication on the County Court the power to create indebtedness against the county.[6]

§ 96. Power of county officers in California.— A board of supervisors of a county have no power to create a debt or liability on the part of the county for any purpose except as provided by law.[7] And no order made by a board of supervisors is valid or binding unless it is authorized by law; thus, if they allow claims

[1] Oakley *v.* Valley County, (Neb. 1894) 59 N. W. Rep. 368.

[2] City of Paterson *v.* Board of Chosen Freeholders, (N. J. 1894) 29 Atl. Rep. 331.

[3] Ibid.

[4] Boydston *v.* Rockwall County, (1894) 86 Tex. 234; s. c., 24 S. W. Rep. 272.

[5] Webb *v.* Spokane County, (Wash. 1894) 37 Pac. Rep. 282.

[6] Fenton *v.* Blair, (Utah, 1895) 39 Pac. Rep. 485.

[7] Foster *v.* Coleman, (1858) 10 Cal. 278.

not legally chargeable to a county, neither the allowance nor the warrants drawn therefor create any legal liabilities.[1] They are authorized to erect a county jail without a law authorizing the levy of a special tax therefor, and the expenses of such erection, as among the expenses of a current year, may be paid for out of the money raised by the general tax which the board are authorized to levy. And a contract entered into by a board of supervisors for this purpose, for and on behalf of the county, and signed by the chairman of the board, would be the contract of the county.[2] So far as concerns the examination and settlement of accounts and claims against a county, its board of supervisors are a *quasi* judicial body, and the allowance and settlements of such a board is an adjudication of the claims, and is conclusive. And an auditor of a county cannot assume to set up his judgment in opposition to that of a board of supervisors in respect to the issuance of a warrant on an account against the county, except in cases where the board have exceeded their powers.[4] Nor can he refuse to issue a warrant when the board of supervisors has ordered its issue, because the person in whose favor it is to be drawn, and whose account has been allowed, has committed a fraud on the county in relation to procuring the contract on which the warrant is to be issued.[5] If by a contract of a board of supervisors for the erection of a county jail it be provided that the work and labor be paid for in installments, on the certificate of the architect that a certain sum has been expended, an account giving the sum total of an installment, without "all the items of the claim" certified by the architect, would be a sufficient compliance with the statute (Pol. Code Cal. § 4072) to authorize the board to allow the same.[6] It cannot set apart a portion of the revenue of the county as a fund for current expenses.[7] They have no authority to allow an unaudited claim against a county, except within one year after the claim accrues and becomes due.[8] The board must first give public notice of a special meeting at which it proposes to settle with the county treasurer, and specify

[1] Linden *v.* Case, (1873) 46 Cal. 171.
[2] Babcock *v.* Goodrich, (1874) 47 Cal. 488.
[3] El Dorado Co. *v.* Elstner, 18 Cal. 144; Tilden *v.* Sacramento Co., 41 Cal. 68; Colusa County *v.* De Jarnett, 55 Cal. 373.
[4] Babcock *v.* Goodrich, (1874) 47 Cal. 488.
[5] Ibid.
[6] Ibid.
[7] Laforge *v.* Magee, 6 Cal. 285.
[8] Carroll *v.* Siebenthaler, 37 Cal. 193.

in the notice that such business will be transacted; otherwise they cannot settle with the officer.[1] Unless specially authorized by law, the board cannot allow the salary of a county treasurer out of county funds.[2] A county treasurer, authorized to advertise for bids for the surrender of bonds of the county, in order that he may redeem them with money in the treasury, has no authority in the advertisement to insert a condition upon which bids will be received, which is not to be implied from the duty to advertise, and which is not necessary to the exercise of his authority, such as that the bonds must accompany the bid.[3] The County Government Act of California authorizes the county boards of supervisors to issue bonds, and provides that the bonds shall be delivered to the county treasurer, by whom they shall be sold to the highest bidder. Under the section of that act, which further authorizes these boards to do "all other acts and things * * * which may be necessary to the full discharge of the duties of the legislative authority of county government," they have been held to have no power to employ an agent to procure bids to be made for such bonds.[4]

§ 97. **Power of county boards in Illinois.**—The governing authorities of a county, elected by the people and becoming their agents for the management of the financial affairs of the county, when they act within the scope of their authority, however indiscreet the action, it is binding upon the county. In an Illinois case, the agents making the contract for a county jail for a price in excess of what was ordered by the County Court, yet the County Court, acting as such, having received the jail and appropriated it to the use of the county, and acknowledged that the county owed the contractors the balance due upon the contract price, this final action of the County Court was held to bind the county to pay the full amount due the contractors, notwithstanding the fact that those making the contract exceeded their authority so far as the price fixed for the cost of the building was concerned.[5] Only such powers can be exercised by County Courts, when sitting for the disposition of county busi-

[1] El Dorado Co. *v.* Reed, 11 Cal. 131.
[2] County of San Joaquin *v.* Jones, 18 Cal. 327.
[3] Mills *v.* Bellmer, (1874) 48 Cal. 124.
[4] Smith *v.* Los Angeles County, (1894) 99 Cal. 628; s. c., 34 Pac. Rep. 439.
[5] County of Jackson *v.* Hall, (1870) 53 Ill. 440.

ness, as have been conferred on them by express law or that it may be necessary to exercise in order to carry into effect the powers granted to them. So, where an act to enable counties to liquidate their debts provides that the County Courts or other governing boards may levy a special county tax for that purpose, the county board has no authority to take up its outstanding orders and give bonds in the place of them, bearing interest. Such obligations cannot be issued without express statutory authority. Another statute, under which the board would be acting in such case, would confine the court to a liquidation through a levy of taxes for that purpose.[1] A county board having authority to contract for the repair of a county court house and building of fire-proof vaults, in the absence of any restrictions of law as to the amount of the price they should pay or its mode of payment, it is open to such board to contract to pay for such work in interest-bearing orders as well as in non-interest-bearing orders.[2] The governing authorities of a county, intrusted with exclusive power over the county revenues and their collection, if, in their judgment a tax already ordered be found to be unnecessary, have a right to rescind the order and arrest the collection of such tax.[3] They are not authorized to allow in a settlement with him to a collector more than the sum fixed by law as fees or commissions, and an allowance of the kind does not bind the county, nor is the county estopped by the action of the board to object to such allowance.[4] It being their duty to protect the county's interest, they have the power to appoint agents, to employ counsel, and make legal contracts for procuring information and evidence necessary and proper in defense of suits against the county.[5] The power given by statute to the board of county commissioners to construct a court house, for instance, and connected with it the power to make contracts for its construction, carries with it of necessity the power to exercise its discretion of settling and adjusting claims against the county arising from such construc-

[1] County of Hardin *v.* McFarlan, (1876) 82 Ill. 138.

[2] County of Jackson *v.* Rendleman, (1881) 100 Ill. 379, holding such orders valid and the interest collectible. The court distinguished County of Hardin *v.* McFarlan, 82 Ill. 138, 141, and Hall *v.* Jackson County, 95 Ill. 352.

[3] People ex rel. Chase *v.* County Court of Macoupin County, (1870) 54 Ill. 217.

[4] Board of Supervisors of Cumberland County *v.* Edwards, (1875) 76 Ill. 544.

[5] Gillett *v.* Board of Supervisors of Logan County, (1873), 67 Ill. 256.

tion, and in case, under this power, in the use of their discretion, a board has settled and compromised a claim about which there was dispute, in the absence of anything showing fraud or corruption on their part, a court of equity has no jurisdiction to prevent the consummation of the agreement of the board for a compromise by process of injunction.[1]

§ 98. Power of county commissioners in Indiana.— The board of county commissioners in Indiana is a body corporate and politic, under the statute. The statute authorizes the board to make contracts, and it may make them by parol in some cases, and be bound thereby; but it cannot make contracts of all descriptions and for all purposes for which natural persons may. It is confined in making contracts to the powers expressly granted to it by the act of its creation, and to the implied powers, incidental and necessary to the execution of such expressed powers and the performance of the duties enjoined upon it. For these purposes, it may make contracts, and it will be bound to perform them the same as individuals.[2] The law of Indiana conferring no powers, and enjoining no duty, upon the board of commissioners of a county to aid in the arrest, prosecution or

[1] Harms *v.* Fitzgerald, (1878) 1 Bradw. (Ill.) 325. In support of this rule, see Attorney-General *v.* Aspinall, 2 Mylne & C. 618; Parr *v.* Attorney-General, 8 Clark & F. 409; Attorney-General *v.* Poole, 4 Mylne & C. 17; Attorney-General *v* Lichfield, 13 Sim. 547; Attorney-General *v.* Norwich, 16 Sim. 225; Mooers *v.* Smedley, 6 Johns. Ch. 28; Livingston *v.* Hollenbeck, 4 Barb. 10, 14; Meserole *v.* Mayor & Common Council of Brooklyn, 8 Paige, 198; Gillespie *v.* Broas, 23 Barb. 370; Andrews *v.* Board of Supervisors Knox County, 70 Ill. 65; City of Galena *v.* Corwith, 48 Ill. 423; Brush *v.* City of Carbondale, 78 Ill. 74; Conrad *v.* Trustees of Ithaca, 16 N. Y. 168; Storrs *v.* City of Utica, 17 N. Y. 104. As to the power of county board, see Prest. and Trustees of Town of Petersburg *v.* Mappin, 14 Ill. 193. That the decision of the board in such a matter is final, see Supervisors of Orleans *v.* Bowen, 4 Lans. 24, 33; Shank *v.* Shoemaker, 18 N. Y. 489; Russell *v.* Cook, 3 Hill, 504; Stover *v.* Mitchell, 45 Ill. 213; County Comrs. of Lucas County *v.* Hunt, 5 Ohio St. 488.

[2] Hight *v.* Board of Comrs. Monroe County, (1879) 68 Ind. 575; citing Seibrecht *v.* City of New Orleans, 12 La. Ann. 496; Douglass *v.* Mayor & Bd. of Aldermen of Virginia City, 5 Nev. 147; Hayward *v.* Davidson, 41 Ind. 212; McCabe *v.* Board of Commissioners of Fountain County, 46 Ind. 380; Burnett *v.* Abbott, 51 Ind. 254; Gordon *v.* Board of Comrs. Dearborn County, 52 Ind. 322; Board of Comrs. Jackson County *v.* Applewhite, 62 Ind. 464; Board of Comrs. Jennings County *v.* Verbarg, 63 Ind. 107.

conviction of a person charged with the commission of crime, either by an offer of reward or by the employment of detective or professional skill, a contract by such a board to pay a reward for the arrest of a criminal has been held to be beyond its powers and not enforceable against the county.[1] A county board cannot authorize the county treasurer to employ an attorney to assist in the collection of delinquent taxes, at the county expense.[2] County boards have no authority to make allowances for services done or things furnished voluntarily for which they cannot lawfully contract.[3] Should such improper allowances be made, relief may be had from it by an appeal.[4] County boards may contract for an examination and adjustment of the accounts of a

[1] Board of Comrs. of Grant Co. *v.* Bradford, (1869) 72 Ind. 455. The court considered the case within the principle of Hight *v.* Board of Commissioners of Monroe County, (1879) 68 Ind. 575, where it was held that such board had no power to employ a person to aid the state's attorneys in prosecuting, and procuring to be prosecuted, a person charged with crime. To the same effect, see Board of Comrs. Ripley County *v.* Ward, (1880) 69 Ind. 441, holding that the board had no power to employ an attorney to assist in the prosecution of one under indictment for embezzling county funds.

[2] Miller *v.* Embree, (1882) 88 Ind. 133.

[3] Ibid.

[4] Board of Comrs., etc., *v.* Gregory, 42 Ind. 32; Grusenmeyer *v.* City of Logansport, 76 Ind. 549; Rothrock *v.* Carr, 55 Ind. 334. See Waymire *v.* Powell, (1885) 105 Ind. 328, holding an allowance by a board of commissioners to one or more of its members for services rendered in inspecting, examining and measuring the abutments of a bridge which had been built under a contract made with the board, to be an illegal allowance, and that any person interested had a right to appeal from such allowance. The court said: "[The statute] provides that 'The boards of commissioners may make allowances at their discretion,' etc., but, as was said, in Rothrock *v.* Carr, 55 Ind. 334, this does 'not mean an arbitrary, uncontrolled, unlimited discretion, contrary to law, or without authority of law; for where there is no law there is no act to do, and, therefore, no discretion to be exercised.' The discretion, therefore, must be according to and in subordination to the law, and not outside and in violation of it." English *v.* Smock. 34 Ind. 115; s. c., 7 Am. Rep. 215. * * * "Where the board of commissioners of their own motion do an act which under the law they may do or not, as in the exercise of their discretion seems best, and the time and mode of doing the act are not prescribed by law, no appeal lies from their decision in such a case. But when they make an allowance which is illegal and appears so on its face, any one aggrieved may appeal." In the cases of Nichols *v.* Howe, 7 Ind. 506; Board of Comrs., etc., *v.* Boyle, 9 Ind. 296; Sims *v.* Board of Comrs., etc., 39 Ind. 40; Moffit *v.* State ex rel., 40 Ind. 217; Board of Comrs., etc., *v.* Richardson, 54 Ind. 153, where such an appeal was denied, the allowances were for services which might have been made the subject of a contract.

county treasurer.[1] The county commissioners have no power to declare, even by express contract, a man's taxes paid before they are assessed, and merely ministerial officers, such as the treasurer and auditor, have no such authority.[2] Among the powers of such boards fixed and designated by law is not the right to interfere with, or in any way affect, the course marked out for the collector or treasurer of the county. They can neither abridge nor enlarge the duties or liabilities of those officers. It follows that an order of such a board giving the collector of the county revenue a longer time for payment of the revenue of the year than the law prescribes, would be without authority, and inoperative.[3] A board of county commissioners, under the statutes, have no power to direct the county treasurer how, or where, he shall keep the county funds; and if a county treasurer, under an order of such board, they having purchased an iron safe, keep the county funds in such safe, this order, being without authority, would not release the collector from his liability to the county to make good the loss, in case the funds be stolen from the safe.[4] County commissioners in Indiana are not empowered by the statute relating to proceedings to secure free gravel roads to order payments of fees of attorneys rendered to the petitioners for such roads.[5]

§ 99. Power of supervisors of counties in Iowa.— County boards of supervisors must act as a board in session in order to bind a county, they not being authorized to bind the county by a

[1] Duncan *v.* Board of Comrs. of Lawrence County, (1884) 101 Ind. 403. It was said: "The board of commissioners have very full powers in reference to the management of the affairs of their respective counties. It is, for all financial purposes, the county, and its contract in relation to the adjustment of the finances of the county is the contract of the county, and valid as such." See Hoffman *v.* Board, etc., 96 Ind. 84; Moon *v.* Board, etc., 97 Ind. 176; Nixon *v.* State ex rel., 96 Ind. 111.

[2] Scobey *v.* Decatur County, (1880) 72 Ind. 551.

[3] Coman *v.* State ex rel. Armstrong, (1836) 4 Blackf. (Ind.) 241.

[4] Halbert *v.* State ex rel. Board of Comrs. Martin County, (1864) 22 Ind. 125. As to contracts in relation to bridges entered into by county boards or superintendents appointed by the board, see Board Comrs. Carroll County *v.* O'Connor, (1894) 137 Ind. 622; s. c., 37 N. E. Rep. 16; Smith *v.* Comrs., 6 Ind. App. 153. As to county board contracting with a physician for services in attending the poor, see Woodruff *v.* Comrs. of Noble County, (1894) 10 Ind. App. 179; s. c., 37 N. E. Rep. 732.

[5] Board of Comrs. of Rush County, *v.* Cole, (1891) 2 Ind. App. 475; s. c., 28 N. E. Rep. 772.

contract made by them individually.[1] That a contract made with a board of supervisors be entered on the supervisors' record is not necessary to its validity, as the contract may be proved by parol.[2] There is no authority in the chairman of the board of supervisors to contract with an attorney for services in a suit in which the county is interested, but the board of supervisors may confer such authority upon the chairman, and, in case this is done, such a contract would bind the county.[3] A county has been held not to be bound by a contract for building materials for a public building, made by the chairman of a building committee who was also chairman of the board of supervisors of the county, as there was shown no special authority from the board to him to make such contract, and such authority could not be inferred from the simple facts that he was chairman of the building committee and of the board of supervisors.[4] Further, that no obligation could be created against the county by an assurance of the chairman of the board that they would pay the bill, as to bind the county a majority of the members must assent to such an assurance.[5] These boards have power, implied from their power under statutes "to represent their respective counties, and to have the care and the management of the property and business of the county in all cases where no other provision is made," to employ one to assist in the collection of taxes not collectible by the county treasurer in the discharge of his duty.[6] It has been held that they have the power to offer a reward for the recovery of money stolen from the county, by necessary implication from the statutes giving them full control of county property, and the care and management thereof;[7] but not for the arrest of persons charged with the commission of crime.[8]

[1] Jordan *v.* Osceola County, (1882) 59 Iowa, 388; s. c., 13 N. W. Rep. 344.

[2] Ibid., following Tatlock *v.* Louisa County, 46 Iowa, 138. The same rule recognized in Baker *v.* Johnson County, 33 Iowa, 151, 153; Rice *v.* Plymouth County, 43 Iowa, 136.

[3] Tatlock *v.* Louisa County, (1877) 46 Iowa, 138.

[4] Rice *v.* Plymouth County, (1876) 43 Iowa, 136.

[5] Ibid.

[6] Wilhelm *v.* Cedar County, (1878) 50 Iowa, 254.

[7] Hawk *v.* Marion County, (1878) 48 Iowa, 472.

[8] Ibid. The court said: "It is the duty primarily of the state to cause the arrest and conviction of criminals, in the performance of which the state makes use of such officers and agencies as it sees proper, and, if the general assembly saw proper, there is no doubt a duty in respect thereto could be legitimately imposed on counties.

§ 100. Power of county commissioners in Kansas.— After a vote of the people in favor of it, county commissioners have power to borrow money to meet the current expenses of the county in case of a deficit in the county revenue and to issue the bonds of the county for the loan.[1] It is within the scope of the authority of a board of county commissioners to determine whether an election has been had authorizing them to subscribe stock in a railroad company, and to subscribe such stock when such election has been held, and to make all necessary orders with reference to the matter.[2] The county commissioners alone possess the power to contract for the county or to create an indebtedness against the county for articles, as mattings for the floor, for instance, to be used about the court houses.[3] And the board will not be bound for a debt created for such purposes by the court or the sheriff of the county, without the consent of the county commissioners.[4] They have no power to appropriate the fund raised by taxation to defray county charges and expenses of the current year to the erection of permanent county buildings.[5] And in case a board has contracted for the erection of permanent county buildings, when it was beyond their power as county officers to make such contracts, and propose to carry out the terms of the contract at the cost of the county, and to use the general revenue fund to pay for the work done under such contract, they may be restrained by injunction from erecting the buildings, or from drawing any warrants on the county treasurer on account of the contract.[6] Medical services to prisoners confined in county

But instead of doing so, the statute expressly authorizes the governor, in certain specified cases, to offer a reward for the apprehension of persons charged with crimes of murder or arson. Code, § 58. The statutes in Maine, as to the power of towns, in this respect, are much like ours as to counties, and there also the governor is authorized to offer rewards in certain cases. It was held in Gale *v.* South Berwick, 51 Me. 174, that towns in that state had no power to offer rewards for the arrest of criminals. Such seems also to be the rule in Illinois. County of Crawford *v* Spenney, 21 Ill. 288. But a contrary rule was adopted in Borough of York *v.* Forscht, 23 Pa. St. 391, on the ground that the burgesses of the borough were a part of the public police. Janvrin *v.* Town of Exeter, 48 N. H. 83, is not applicable because the power in that state is conferred by statute, and such is true as to Crawshaw *v.* City of Roxbury, 7 Gray, 374."

[1] Doty *v.* Ellsbree, 11 Kans. 209.

[2] State ex rel. *v.* Allen, 5 Kans. 213.

[3] Neosho County *v.* Stoddart, 13 Kans. 207.

[4] Ibid.

[5] State ex rel. *v.* Marion County, 21 Kans. 419.

[6] Ibid.

jails must be authorized by the county board, otherwise the county will not be liable for them.[1] A county having no poor-house may be bound by a township trustee to pay for medical services furnished to a poor person, who is a resident of the county and township, and who is temporarily a pauper.[2] The allowance of a claim against a county by its county commissioners is not final and conclusive. The board itself may re-examine it, and, on appeal, it may be examined and disallowed in whole or in part by the court to which the right of appeal in such cases is given.[3] Where a claim against a county has been disallowed in whole or in part by the county commissioners, it is the right of the claimant to appeal to the District Court or to commence an original action for it.[4] Two members of a board of county commissioners cannot enter into a contract to bind the county, outside of the county, without previous authority from the board.[5] Under the statute of Kansas empowering the county commissioners of a county "to purchase at their true value any and all bridges built upon the public highways of said county by any township or private person or persons, and pay for the same in county bonds," they have no authority to purchase such bridges and pay for them with county warrants or orders; nor have they power to purchase such bridges at the original cost of their construction, where that cost exceeds the "true value" of the bridges.[6]

§ 101. **Power of County Courts in Kentucky.**— County courts have no power to impose a tax in aid of a railroad on the people of a county or to submit the question of taxation to popular vote without some special legislative enactment authorizing it.[7] Such courts have power to employ counsel to defend a suit against the counties and test the validity of a subscription of the counties to a private corporation and to bind the counties for a reasonable fee.[8] And in a suit by the attorney for the recovery

[1] Roberts *v.* Pottawatomie County, 10 Kans. 29.

[2] Board of Comrs. of Clay County *v.* Renner, 27 Kans. 225.

[3] Leavenworth County *v.* Keller, 6 Kans. 510.

[4] Leavenworth County *v.* Brewer, 9 Kans. 307.

[5] Board of Comrs. of Hamilton Co. *v.* Webb, (1891) 47 Kans. 104; s. c., 27 Pac. Rep. 825.

[6] State of Kansas *v.* Pierce, (1893) 52 Kans. 521; s. c., 35 Pac. Rep. 19.

[7] B. G. & M. R. R. Co. *v.* Warren County Court, 10 Bush, 718.

[8] Garrard County Court *v.* McKee, 11 Bush, 236.

of his fee, the judgment of the County Court as to what was beneficial for the county, and the employment of counsel to effect the object cannot be questioned.[1] So have they power to employ counsel to resist the application of a railroad company for a *mandamus* to compel the court to subscribe for its stock and to issue the bonds of the county to pay the subscription; and the County Levy Court should make provision for the payment of a reasonable compensation for the services rendered under such employments.[2] They may appropriate money toward paying the cost of additional buildings erected by a society which supports a portion of the poor children of the county, as the authority given them to purchase land and establish poorhouses is not compulsory and could not constructively abolish the power to provide for the poor in other modes.[3] The power given to employ physicians to inoculate the poor does not empower them to employ a physician for the general treatment of the smallpox.[4] They are authorized to employ medical aid for the relief of poor persons afflicted with smallpox without regard to the color of such persons.[5] The county judge and justices, those constituting the tribunal in charge of county matters in Kentucky, are the judges of the need of a poorhouse, and may purchase land for such purpose and make the necessary improvements.[6]

§ 102. **Power of supervisors in Michigan.**— Unless distinctly authorized by legislation, a board of supervisors cannot incur debts or make engagements, except as the basis of benefit to the county it represents.[7] The power of raising money reposed in boards of supervisors is confined to raising it for none but necessary uses, and all loans negotiated by them must be for some of the purposes mentioned in the statute.[8] They cannot delegate to a committee or third parties such powers as the law requires to be submitted to their own discretion and judgment.[9] They cannot delegate to the county treasurer the auditing of

[1] Ibid.

[2] Washington County Court *v.* Thompson, 13 Bush, 241.

[3] Orphan Society of Lexington *v.* Fayette County, 6 Bush, 415.

[4] Pusey *v.* Meade County Court, 1 Bush, 218.

[5] Rodman *v.* Justices of Larue County, 3 Bush, 145.

[6] Jones *v.* Pendleton County Court, (Ky. 1892) 19 S. W. Rep. 740.

[7] Stamp *v.* Cass County, 47 Mich. 330; s. c., 11 N. W. Rep. 183.

[8] Davis *v.* Board of Supervisors of Ontonagon County, 64 Mich. 404; s. c., 31 N. W. Rep. 405.

[9] Maxwell *v.* Bay City Bridge Co., 41 Mich. 453; s. c., 2 N. W. Rep. 639;

accounts against the county.[1] A resolution of a board of supervisors providing for the raising of money to be paid over to the towns, without any definition of purposes, and to be spent under a town officer's direction, would be invalid, as the board must exercise its own judgment in expending money for roads under its control.[2] There is a presumption that the action of a board of supervisors in voting money for a bridge or for county buildings is lawful.[3] In allowing pay for services as to which the law is silent, a board of supervisors has considerable discretion, which it must exercise if a proper case, in its judgment, arises.[4] Where the determination of a board of supervisors is conclusive not only as to the propriety of making an allowance, but as to the amount, *mandamus* will not lie to control their action.[5] Neither will *mandamus* lie to compel a board of auditors to allow a demand rejected by it on the ground of non-performance of the services charged for.[6]

§ 103. Power of County Courts in Missouri.— County Courts in Missouri are the administrative agents of the counties, and can only exercise the powers conferred on them by statute.[7] Their acts within the course prescribed by the statutes are binding upon the county; if beyond, they are not binding.[8] They may make verbal contracts,[9] but cannot bind the counties to all the contracts they may choose to make.[10] If an order of record of a County Court show the subsequent ratification and approval of a contract made by an agent, under a mere verbal appointment, the contract will, notwithstanding the irregularity, be as binding upon the county as if the appointment had been properly

People *v.* St. Clair County Officers, 15 Mich 85.

[1] Vincent *v.* Mecosta County Supervisors, 52 Mich. 340; s. c., 17 N. W. Rep. 938.

[2] Attorney-General *v.* Bay Supervisors, 34 Mich. 46.

[3] Stockle *v.* Silsbee, 41 Mich. 615; s. c., 2 N. W. Rep. 900.

[4] Lee *v.* Board of Supervisors of Ionia County, 68 Mich. 330; s. c., 36 N. W. Rep. 83.

[5] Mixer *v.* Manistee County Supervisors, 26 Mich. 422.

[6] People *v.* Wayne Auditors, 10 Mich. 307.

[7] State *v.* Shortridge, (1874) 56 Mo. 126.

[8] Saline County *v.* Wilson, (1875) 61 Mo. 237; Sturgeon *v.* Hampton, (1885) 88 Mo. 203. County Courts as agents. State ex rel. Quincy, Mo. & Pac. Ry. Co. *v.* Harris, (1888) 96 Mo. 29; s. c., 8 S. W. Rep. 794.

[9] Hase *v.* Warren County, (1877) 3 Mo. App. 567.

[10] Alderson *v.* St. Charles County, (1879) 6 Mo. App. 420.

made in the first instance.[1] Contracts with County Courts must be proved by the record alone, and cannot be varied, contradicted or destroyed by oral evidence of the intention of the judges.[2] Their contracts cannot bind parties with whom they profess to contract by simply reciting the alleged contracts on their records. The assent of the contracting party must appear.[3] They have no implied power to levy a tax. The power must be clearly and expressly given by statute. And if the statute imposes conditions upon which it is to be exercised, those conditions must be observed before the exercise of the power to levy a tax would be lawful.[4] They cannot alter the assessment of taxes to build school houses on the mere ground that a school house was unnecessary,[5] but may compromise disputed claims for taxes.[6] They may contract for insurance upon the county buildings against fire or lightning.[7] They would have no authority to employ counsel at the expense of the county to litigate a question as to whether a scheme of separation had been adopted, the effect of which was to abolish the County Court, but in which the county asserted no claim adverse to that of either party;[8] but may, by an order of record, employ attorneys to aid the prosecuting attorney in any civil business, upon such terms as they may deem proper, if, in the judgment of the courts, the interests of the counties require it.[9] They have no power to issue county certificates of indebtedness;[10] neither is it in their power to discount county warrants in payment of a county debt.[11] They have no authority to issue a a warrant for money expended by the sureties of a defaulting and absconding county treasurer in bringing him back to the county.[12] In case a county treasurer pays a warrant when there is no money in the fund on which it is drawn, he cannot recover

[1] Walker *v.* Linn County, (1880) 72 Mo. 650.

[2] County of Johnson *v.* Wood, (1884) 84 Mo. 489.

[3] Riley *v.* Pettis County, (1888) 96 Mo. 318; s. c., 9 S. W. Rep. 906.

[4] State ex rel. Clinton County *v.* Hannibal & St. Joseph R. R. Co., (1885) 87 Mo. 236.

[5] In re Petition of Powers, (1873) 52 Mo. 218.

[6] St. Louis, Iron Mt. & So. Ry. Co. *v.* Anthony, (1881) 73 Mo. 431.

[7] Walker *v.* Linn County, (1880) 72 Mo. 650.

[8] Henley *v.* Clover, (1878) 6 Mo. App. 181.

[9] Thrasher *v.* Greene County, (1885) 87 Mo. 419.

[10] Smallwood *v.* Lafayette County, (1882) 75 Mo. 450.

[11] Bauer *v.* Franklin County, (1873) 51 Mo. 205.

[12] Hooper *v.* Ely, (1870) 46 Mo. 505.

the amount from the county; and it does not matter that the payment be made at the instance of the County Court, and upon their promise that the amount would be made good, nor that the warrant was received from the treasurer and canceled by the court.[1]

§ 104. Power of county supervisors in New York.— A county cannot be bound by any acts of a board of supervisors, except within the limits of the express power conferred upon them by statute.[2] A county may be bound by a majority of the board of supervisors, lawfully convened, unless it be otherwise expressly provided by law.[3] Such boards having no inherent power to borrow money or to issue negotiable paper, must have statutory authority, express or implied, to do so.[4] Money having been properly raised for a legitimate object, a board of supervisors of a county may change its appropriation, and devote it to another object within the scope of their powers.[5] Under a power given a board of supervisors to provide for a permament location of an armory, by erecting it, they may hire a building for that purpose for a term of years.[6] The execution of its mechanical and physical work may be delegated by a board of supervisors when acting as a mere business corporation in the same manner as by any other corporation.[7] A building committee authorized by a resolution of a board of supervisors "to advertise for sealed proposals," the work "to be let to the lowest responsible bidder, the building committee, together with the architect, to furnish the necessary plans and specifications," would not be authorized to enter into a contract, but simply to take the steps preliminary to the execution of one.[8] A board of supervisors has no authority to contract, in advance, for necessary printing for county officers, but they are bound to audit an account for such printing.[9] And

[1] Cook *v.* Putnam County, (1879) 70 Mo. 668.

[2] Chemung Canal Bank *v.* Supervisors of Chemung, 5 Denio, 517.

[3] People *v.* Brinkerhoff, 68 N. Y. 259.

[4] Parker *v.* Supervisors of Saratoga, 106 N. Y. 392; s. c., 13 N. E. Rep. 308.

[5] People *v.* Baker, 29 Barb. 81.

[6] People ex rel. Stockwell *v.* Earle, (1874) 47 How. Pr. 370.

[7] People *v.* Supervisors of Rensselaer, 52 Hun, 446; s. c., 5 N. Y. Supp. 600.

[8] Ibid.

[9] People *v.* Supervisors of Cortland, 58 Barb. 139; s. c., 40 How. Pr. 53. As to the principle, see People *v.* Supervisors of New York, 21 How. Pr. 288; People *v.* Supervisors of New York, 22 How. Pr. 71.

they cannot bind a county for the payment of the expenses of a litigation by an individual to establish his rights to an office.[1] They have no power to control the disbursements of the poor fund in the hands of the county treasurer.[2] The general power of supervisors of a county to maintain actions includes the power to compromise a doubtful claim on which an action has been brought.[3] Under the power conferred by statute upon the supervisors of a county to provide for the erection of bridges, they may appoint commissioners to carry out the work.[4] A board of supervisors may pass upon and audit a claim for repairs to a county building in case the facts proved raise an inference that the committee of the board ordering the repairs to be made were authorized to do so by the board, and gave directions for the repairs by one of its members.[5] A board of supervisors, where no definite or fixed sum is prescribed as compensation for services rendered for a county, is vested with discretion, and may allow such sum as may seem just.[6] In the statutory power of a board of supervisors to examine, settle and allow all accounts chargeable against a county, is implied the exercise of judgment and discretion, and they have the right and power to reject a claim for sufficient reasons.[7] A board of supervisors, in case they have been induced by misconception of fact to audit and allow a claim against a county, may reconsider and reverse their action in the matter.[8] Supervisors should ascertain whether the county is liable for services rendered at the request of an overseer of the poor who has confessed judgment for the same before they allow the claim against the county.[9] They cannot allow a claim against a county on their own notions as to its being an equitable one.[10]

[1] Supervisors of Richmond County *v.* Ellis, (1875) 59 N. Y. 620.

[2] People *v.* Demarest, 16 Hun, 123.

[3] Supervisors of Orleans County *v.* Bowen, 4 Lans. 24.

[4] People *v.* Meach, 14 Abb. Pr. (N. S.) 429.

[5] Cogan *v.* Mayor, etc., of New York, 5 Hun, 291.

[6] People ex rel. *v.* Supervisors of St. Lawrence County, 30 How. Pr. 173.

[7] People *v.* Supervisors of Dutchess County, 9 Wend. 508; People *v.* Supervisors of Warren County, 1 How. Pr. 116.

[8] People ex rel. *v.* Supervisors of Broome County, 65 N. Y. 222.

[9] Gere *v.* Supervisors of Cayuga County, 7 How. Pr. 255; People *v.* Supervisors of Delaware County, 12 How. Pr. 50.

[10] Chemung Canal Bank *v.* Supervisors of Chemung County, 5 Denio, 517. As to the duty of supervisors in auditing claims against a county, see People ex rel. *v.* Supervisors of St. Lawrence County, 30 How. Pr. 173.

They have no power to indemnify a justice of the peace against the expenses of his defense in impeachment.[1]

§ 105. Power of county commissioners in Pennsylvania.—A county is not bound by a contract made by one county commissioner.[2] But two of the commissioners may bind the county by a contract made in their official capacity, though not at their office.[3] County commissioners in Pennsylvania have power to purchase everything necessary for the accommodation of persons employed in conducting a general election.[4] But they cannot bind a county by a prior agreement to pay costs on a *nolle prosequi* with leave of court.[5] To bind a county by an informal agreement made by two of its commissioners within the scope of their powers, such agreement must be expressly or impliedly ratified and confirmed by its commissioners acting as a board.[6] They may also bind a county by a contract for the removal of an insane prisoner to a hospital and his maintenance therein.[7] County commissioners can only contract with counsel to represent the county in litigation for a reasonable compensation.[8]

§ 106. Power of county boards in Wisconsin.—A county board may bind the county by contracts as to matters within their control, but not as to matters intrusted to a particular officer.[9] A county board may, by resolution, confer upon a committee of its number the power to purchase a poor farm.[10] And the county will be bound by the action of such committee in making a purchase of a poor farm and accepting the deed and liable for the price of the same without any further action of the county board ratifying the purchase.[11]

§ 107. Power of township trustees in Indiana.—Township trustees may levy a tax to build school houses.[12] And a contract

[1] People *v.* Lawrence, 6 Hill, 244.

[2] Treichler *v.* Berks County, 2 Grant's Cas. (Pa.) 445.

[3] Jefferson County *v.* Slagle, 66 Pa. St. 202.

[4] Commonwealth *v.* Commissioners of Philadelphia, 2 Serg. & R. 193.

[5] Berks County *v.* Pile, 18 Pa. St. 493.

[6] Township *v.* County, 2 Woodward's Dec. (Pa.) 194.

[7] Allegheny County *v.* Western Pennsylvania Hospital, 48 Pa. St. 123.

[8] County *v.* Barber, 97 Pa. St. 455.

[9] Beal *v.* St. Croix County, 13 Wis. 500.

[10] French *v.* Dunn County, 58 Wis. 402.

[11] Ibid.

[12] Adamson *v.* Auditor, 9 Ind. 175.

of township trustees for building such houses is binding on the township.[1] An order of a board of trustees of a township signed by the clerk and president of the board, requiring the treasurer to pay a fixed sum for building a school house, was in this case held to be a valid demand against the township.[2] A township trustee has no authority to borrow money or to execute notes in the name of the school township.[3] The trustee of the school township in this case borrowed money from a bank and executed notes of the corporation for the loan. He deposited the money in the bank in his own name and drew upon it as an individual. The Supreme Court of Indiana held that this was a transaction between him and the bank, and that the township was not liable upon the note.[4] On the petition for a rehearing of this case the court adhered to the opinion that the trustee of a school corporation was a special agent of very limited authority; that not only was he a special agent, but that he was one whose authority was only such as the public statute conferred upon him.[5]

[1] Crist *v.* Brownsville Township, 10 Ind. 461.

[2] Heal *v.* Jefferson Township of Grant County, (1860) 15 Ind. 431.

[3] Union School Township *v.* First National Bank of Crawfordsville, (1885) 102 Ind. 464; Bicknell *v.* Widner School Township, 73 Ind. 501; Wallis *v.* Johnson School Township, 75 Ind. 368; First National Bank *v.* Union School Township, 75 Ind. 361; Pine Civil Township *v.* Huber Manufacturing Co., 83 Ind. 121; Reeve School Township *v.* Dodson, 98 Ind. 497.

[4] Union School Township *v.* First Nat. Bank of Crawfordsville, (1885) 102 Ind. 464. It was said: "The trustee, in the management of the financial affairs of the school township, is a special agent with limited statutory powers. He has no general authority to bind the corporation. His acts create a binding obligation against the school township only when he does the acts which the law authorizes, and does them in the manner which it prescribes. All who deal with him are bound to take notice of the scope of his authority * * *." The court said in Axt *v.* Jackson School Township, 90 Ind. 101: "In dealing with such trustee the appellant was bound to take notice of his fiduciary character, and to know that he could only bind his township by his words and deeds which were authorized by law." It was not in [this trustee's] power, by checks, notes or other instruments, to bind the school corporation unless the claim for which they were given existed against the township, and in this case no claim did exist. Even if the trustee had been guilty of fraud the school corporation would not have been bound. Lowell Five Cents Savings Bank *v.* Inhabitants of Winchester, 8 Allen, 109; Benoit *v.* Inhabitants of Conway, 10 Allen, 528; Dickinson *v.* Inhabitants of Conway, 12 Allen, 487; Kelley *v.* Lindsey, 7 Gray, 287; Railroad Nat. Bank *v.* City of Lowell, 109 Mass. 214.

[5] Union School Township *v.* First National Bank of Crawfordsville, (1885) 102 Ind. 464, 473. Elliott, J., speaking for the court, said: "That

§ 108. Power of selectmen of towns in Massachusetts.— A town cannot be bound by an unauthorized oral promise of its selectmen to pay bounty to a soldier.[1] Where the inhabitants of a town have by vote authorized their treasurer to borrow money for the adjustment of a state tax for the reimbursement of bounties to volunteers, and the tax had been adjusted without the necessity of borrowing money, it was held that the treasurer's authority to borrow money under that vote of the inhabitants ceased upon the adjustment of the tax.[2] Selectmen have no authority, merely *virtute officii*, to make a contract on behalf of a town for the hiring of a building in which town meetings may be held.[3] Selectmen of a town have no authority to bind the town by an offer of a reward for the apprehension and conviction of a person who has not been charged with a crime by complaint or indictment.[4]

§ 109. Power of selectmen of towns in New Hampshire.— Selectmen of towns have no general authority to bind the town by contract.[5] They cannot borrow money upon the credit of the town.[6] Being general agents for towns in respect to pecuniary matters, unless restrained by specific instructions, they are warranted in paying any existing debts of towns which, in the exercise of a sound discretion on their part, should be paid.[7] They

this conclusion is a just one cannot be doubted by one who considers the nature of a school corporation and the character of the authority of its agent, the trustee. The corporation is itself organized for a limited and local purpose. It is not a corporation with general powers; it has neither the general power to contract debts nor to buy property. Its power is to conduct the local school affairs, and to do this with the money derived from the revenues set apart for school purposes. There is, in strictness, no power in the corporation to obtain or to expend money derived from any other source than the school revenues. Wallis *v.* Johnson School Township, 75 Ind. 368. Thus is the power of the corporation itself circumscribed, and its agent, the trustee, can by no possibility possess authority that is not possessed by his principal. It is perfectly obvious, therefore, that one who deals with a school trustee must, at his peril, ascertain that the trustee is acting within his authority. It is incumbent upon a person seeking to hold the corporation liable for a debt created by the trustee in the name of the corporation, to affirmatively show that it was one he had authority to confer."

[1] Barker *v.* Chesterfield, (1869) 102 Mass. 127.

[2] Benoit *v.* Inhabitants of Conway, (1865), 10 Allen, 528.

[3] Goff *v.* Rehoboth, (1846) 12 Met. 26.

[4] Day *v.* Otis, 8 Allen, 477.

[5] Andover *v.* Grafton, 7 N. H. 298.

[6] Rich *v.* Errol, 51 N. H. 350.

[7] Sanborn *v.* Deerfield, 2 N. H. 251

may, in some cases, bind the town by a promissory note, but the holder must show that in giving the note the selectmen acted within the scope of their authority.[1] They may institute a suit in the name of a town to recover back usurious interest.[2] Negotiable notes, the property of a town, may be sold and transferred by selectmen.[3] Adjustment of suits or controversies of a town, not being in their power, as selectmen, they cannot bind the town to the payment of money for such an adjustment by a written contract.[4] A town may be bound by its selectmen for medical services in vaccinating, but not for medical services rendered persons sick with smallpox, who are not paupers. The health officers of a town have no authority to bind the town for medicines and medical services furnished to inhabitants who are not paupers.[5]

§ 110. Power of supervisors of townships in Pennsylvania.— A township cannot be bound by one of its supervisors in a matter requiring deliberation, consultation and judgment. Such a matter must be determined by a majority of the board at a regular meeting.[6] Nor can it be bound by a contract made by one supervisor, without the assent of his colleague, with an attorney for a year at a fixed sum.[7] A township may be bound by a mere ministerial act of a single supervisor, such as the employment of hands and giving due bills for the amount of work done on its roads.[8] In a matter where the township is bound by law to perform the contract made by a single supervisor, it is in the power of this single supervisor to contract if the other refuse his assent.[9] A supervisor has no authority to bind a township by his agreement to pay a bounty for enlistment in United States service.[10]

[1] Andover *v.* Grafton, 7 N. H. 298.

[2] Albany *v.* Abbott, 61 N. H. 157.

[3] West *v.* Errol, 58 N. H. 233.

[4] Underhill *v.* Gibson, 2 N. H. 352.

[5] Wilkinson *v.* Albany, 28 N. H. 9; Farmington *v.* Jones, 36 N. H. 271; McIntire *v.* Pembroke, 53 N. H. 462.

[6] Township *v.* Gibboney, 94 Pa. St. 534. As to liability of a township for a contract made by its supervisors within the apparent scope of their authority, see Cook *v.* Deerfield, 64 Pa. St. 445.

[7] Bohan *v.* Township, 4 Kulp, (Pa.) 234.

[8] Dull *v.* Ridgway, 9 Pa. St. 272; McNeal *v.* Allegheny Township, 1 Am. Law Reg. 124.

[9] Pottsville *v.* Norwegian Township, 14 Pa. St. 543. As to contracts that cannot be made by a single supervisor which will bind the township, see Cooper *v.* Lampeter Township, 8 Watts, 125; McNeal *v.* Allegheny Township, 1 Am. Law Reg. 124; Batten *v.* Brandywine, 3 Clark, (Pa.) 462.

[10] Bearce *v.* Township, 27 W. N. C. (Pa.) 212.

Supervisors of a township may borrow money for the purpose of repairing roads and building bridges, and confess judgment against the township for the amount borrowed.[1] Supervisors of townships have power to contract for making new roads ordered to be opened and building the necessary bridges.[2] It is within the general powers of the supervisors of a township to contract for the erection of a township bridge in place of one destroyed by a freshet.[3] They may bind the township by a promise to repay voluntary subscriptions to a bounty fund.[4] And in case supervisors agree to a division of the charge of the affairs of the township, by apportioning to each a certain part of the district, the acts of each, within the limits assigned to him, will be binding on the township.[5] Supervisors have no right to take up an old certificate of indebtedness issued by the township and issue a new one to the assignee of the original payee.[6]

§ 111. Power of selectmen and agents of towns in Vermont.— A town cannot be bound by a contract made by one selectman, without the knowledge or consent of the others.[7] In case it be shown that the three selectmen of a town agreed together as to the mode in which the business of the town should be transacted and the business was intrusted by two of them to the third one, and he made the contracts with reference to the business of the town, a jury would be justified in finding such assent on the part of the others, or any of them, as to make the act of the one contracting the act of the majority and binding upon the town.[8] Selectmen of a town have no right to receive money collected by a sheriff on an execution in favor of a town and discharge him, it being the duty of the sheriff to pay it to the town treasurer.[9] Selectmen have no authority to draw town

[1] Maneval *v.* Township, 9 Pa. Co. Ct. Rep. 28.

[2] Childs *v.* Brown Township, 40 Pa. St. 332.

[3] Oakland Township *v.* Martin, 104 Pa. St. 303.

[4] Juniata Township *v.* Reamer, 2 W. N. C. (Pa.) 91.

[5] Commonwealth *v.* Supervisors of Colley, 29 Pa. St. 121; Hopewell *v.* Putt, 2 W. N. C. (Pa.) 46. In Sheppard *v.* Township, 4 Del. Co. Rep. (Pa.) 385, where the supervisors had divided their district, the township was held liable for stone purchased by one of the supervisors for the use of the township, and the other supervisors had not dissented from the purchase.

[6] Snyder Township *v.* Bovaird, 122 Pa. St. 442; s. c., 15 Atl. Rep. 910.

[7] Hunkins *v.* Johnson, 45 Vt. 131.

[8] Guyette *v.* Bolton, 46 Vt. 228.

[9] Middlebury *v.* Rood, 7 Vt. 125.

orders in their own behalf in settlement of their own private claims against the town; nor are such orders made effectual by the allowance of the town auditors.[1] Selectmen of a town may submit to arbitration a claim against the town, for instance, for building a bridge, under the statutory powers given them "to audit, and in their discretion to allow, the claim of any person against the town for money paid or services performed for the town."[2] So they may submit to arbitration claims against their towns for damages sustained upon the highways of the towns.[3] The selectmen of a town have the power to settle and stop a suit against a party brought to recover a penalty for not removing an obstruction out of the highway under an order of the selectmen.[4] And the general authority of the selectmen over the subject would not be limited by a vote of the town "to direct the town agent to manage the law suits as he thinks best."[5] A town having appointed an agent for the purpose of "compromising" a claim for damages in the laying of a highway, the agent may refer the claim to arbitration.[6] A town agent, appointed to defend and prosecute suits, has no authority as such to bind the town by a promise to pay a certain sum on settlement of a suit against the town to recover for an injury occasioned by insufficiency of a highway.[7] A town would be bound for professional services of the town agent, who is an attorney, where he is authorized as town agent to employ an attorney to prosecute and defend

[1] Davenport *v.* Johnson, 49 Vt. 403. In Burnham *v.* Strafford, 53 Vt. 610, an action of assumpsit brought by a selectman against the town, the evidence tended to prove that he borrowed for the town a sum of money and gave a town order for the same, to which he attached his own name and the names of the other two selectmen, and paid the money into the town treasury; that the town denied his authority to give the order and refused to pay it, and denied that he had paid the money into the treasury, or that the town ever received any part of it; and upon this refusal and denial on the part of the town, the selectmen took up the order by paying the holder the amount for which it called. The Supreme Court held that, although he could not recover for the amount paid to take up the order as for money paid at the town's request, the town having repudiated the order, nor upon the order itself, it not being negotiable, yet, if in fact he paid into the treasury the sum originally borrowed and he had himself repaid the loan, he could recover in this action.

[2] Dix *v.* Dummerston, 19 Vt. 262.

[3] Hollister *v.* Pawlet, 43 Vt. 425.

[4] Town of Cabot *v.* Britt, (1863) 36 Vt. 349.

[5] Ibid.

[6] Schoff *v.* Bloomfield, 8 Vt. 472.

[7] Clay *v.* Wright, 44 Vt. 538.

suits on behalf of the town.[1] In road cases, where the town agent provides no counsel and makes no objection to the employment of counsel by the selectmen of a town, it is within the scope of the implied powers of the selectmen to protect the interests of their town by the employment of counsel at the charge of the town in such cases.[2] And the assent of the town agent to such employment of counsel by the selectmen may be presumed where he neglects to employ counsel and no dissent on his part is shown.[3]

§ 112. Power of town officers in Wisconsin.— The officers of a town when transcending their lawful authority cannot bind the town.[4] A town may be bound by a contract which it is authorized to make by the joint act of two supervisors.[5] A town board of supervisors is not authorized to compromise and discharge an existing valid judgment in favor of the town, without full payment in money or its equivalent.[6] A town board may, without special authority from the electors, defend a suit against the town, or take an appeal therein.[7] The chairman of a town board may be directed by such board to execute a subscription or bond authorized to be issued by the town, and the act of the chairman will be essentially the act of the board.[8]

§ 113. Power of officers of school districts.—School districts can be bound by their directors by their official acts, and of these acts the minutes of the board are the best evidence.[9] They cannot, by contract, divest themselves of powers conferred for a public purpose.[10] School directors have an absolute discretion as to the necessity of erecting new school houses and of borrowing money to pay for them.[11] Where a committee has been appointed by a school board to get up plans for a new school building and submit them to the board for approval, the committee would be authorized to contract with an architect for plans and specifica-

[1] Langdon *v.* Castleton, 30 Vt. 285.
[2] Burton *v.* Norwich, 34 Vt. 345.
[3] Ibid.
[4] Hubbard v. Lyndon, 28 Wis. 674.
[5] Beaver Dam v. Frings, 17 Wis. 398.
[6] Butternut v. O'Malley, 50 Wis. 329.
[7] Haner v. Town of Polk, 6 Wis. 350.
[8] Hewitt v. Town of Grand Chute, 7 Wis. 282.
[9] Wachob *v.* Bingham School District, 8 Phil. 568.
[10] Conley *v.* Directors of West Deer, 32 Pa. St. 194.
[11] In re School Directors, 3 Kulp, (Pa.), 104; In re School Directors, 2 Pa. Co. Ct. Rep. 497.

tions.[1] Contracts with a school teacher cannot be made except by a vote of the school board; one made by the president and secretary of the board cannot be enforced.[2] As incidents to their power to sell, directors of school districts have power to mortgage the real estate held by them.[3] Where school officers are authorized to make contracts only with the assent of a majority of the electors, a contract made by them without such assent would be void.[4] The officers of a school district may make a valid contract with a qualified teacher extending beyond their own term.[5] A valid contract with one of their number for the purchase of a site for a school house in exchange for bonds may be made by commissioners to receive and negotiate bonds and purchase school sites, the vendor not acting in the transaction as a commissioner.[6] A school district may avoid a contract between a school board and one of the members of the board for the erection of a school house by the latter.[7] Directors of a school district voting for a misapplication of the public funds are personally liable therefor to the township.[8] Where it was found that a school board had conspired with a contractor to defraud the district in the erection of a school building, it has been held in Iowa that under the statute authorizing such boards to employ counsel in suits brought against any of the school officers to enforce the provisions of the school law, they had no power to employ counsel in a suit to enjoin them from accepting and paying for the school building.[9] A *de facto* trustee of a school district may bind the district by his contract with a teacher for the schools.[10] The officers of school districts are limited to the purposes named in the statute prescribing their powers in the matter of raising or expending funds of the school district. In an action against members of a school board of education, for instance, for damages to the business reputation of parties by

[1] McKeesport District *v.* Miller, 1 Pennypacker (Pa.), 510.
[2] School District *v.* Padden, 89 Pa. St. 395.
[3] Morrisville School District, 3 Phil. 181.
[4] Peck *v.* School District, 21 Wis. 516.
[5] Webster *v.* School District, 16 Wis. 316.
[6] Cady *v.* Watertown, 18 Wis. 322.
[7] Pickett *v.* School District, 25 Wis. 551.
[8] Dickinson Township *v.* Linn, 36 Pa. St. 431.
[9] Scott *v.* Independent District of Hardin County, (Iowa, 1894) 59 N. W. Rep. 15.
[10] O'Neil *v.* Battie, (1892) 62 Hun, 618; s. c., 18 N. Y. Supp. 255. See, also, O'Neil *v.* Battie, 61 Hun, 622; s. c., 15 N. Y. Supp. 818.

reason of a refusal on their part to entertain a bid of such parties for furnishing supplies for the schools on the ground that such parties had before dealt dishonestly with the district, the school board would not be authorized to expend the moneys of the district in defending the suit, it being such a matter as the district itself has no interest in.[1] A member of a district school board having no school funds in his hands, not being its treasurer, it has been held in New Hampshire could not recover of the district the money he had paid to a teacher hired by himself to teach one of the schools and for board he had furnished the teacher on the ground that he could contract only on the credit of the school money of the district and not on the credit of the district itself.[2] Directors of a school district in Iowa have power to borrow money to discharge a debt which has been legitimately created, and may pledge the credit of the district for that purpose. But the obligation evidencing the debt can only bear six per cent interest.[3] The district board of primary school districts in Michigan may contract with qualified teachers for such term as shall be determined by the qualified voters of the district at the annual school meeting thereafter to be held.[4] The presumption that a contract with a teacher was authorized by a vote of the school board pursuant to the statute of Wisconsin upon the subject will be raised by the fact that the officers constituting the board signed it. And the mere fact that the officers were not together when they signed it would not tend to disprove that it was so authorized.[5]

[1] Hotchkiss *v.* Plunkett, (1891) 60 Conn. 230; s. c., 22 Atl. Rep. 535.

[2] Wheeler *v.* Alton, (N. H. 1892) 23 Atl. Rep. 89.

[3] Austin *v* District Township of Colony, (1879) 51 Iowa, 102; s. c., 49 N. W. Rep. 1051.

[4] Cleveland *v.* Amy, (1891) 88 Mich. 374; s. c., 50 N. W. Rep. 293.

[5] Dohan *v.* Joint School District No. 13, Towns of Utica & Freeman, (1891) 80 Wis. 155; s. c., 49 N. W. Rep. 960.

CHAPTER IV.

POWER OF AGENTS AND OFFICERS — PRIVATE CORPORATIONS.

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§ 114. Agency in general.—A corporation can only act through a duly authorized agent or committee.[1] Authority may be conferred by a single resolution of the directors for action in a class of cases as well as by a separate resolution in each case.[2] Though a corporation must, in general, act through its common seal, yet it may appoint an agent whose acts, within the sphere of his powers, do not require any such appendage to impart to his acts validity.[3] The powers of an agent of a corporation are such as he is allowed by the directors or managers of the corporation to exercise within the limits of the charter. The silent acquiescence of the directors or managers may be as effectual to clothe the agent with power as an express letter of attorney.[4] A corporation will be bound by a promissory note executed by its agent should he act within the sphere of his power or his act be subsequently ratified.[5] An agent of a corporation acting within the scope of his authority may bind his principal in the same way

[1] Merchants' Union Barb Wire Co. *v.* Rice, (1886) 70 Iowa, 14; s. c., 28 N. W. Rep. 494.

[2] Elwell *v.* Dodge, 33 Barb. 336.

[3] Everett *v.* United States, (1837) 6 Port. (Ala.) 166; citing Bank of Columbia *v.* Patterson, 7 Cranch, 299; Mechanics' Bank of Alexandria *v.* Bank of Columbia, 5 Wheat. 326; Fleckner *v.* United States Bank, 8 Wheat. 339, 358.

[4] Olcott *v.* Tioga R. R. Co., 27 N. Y. 546.

[5] Butts *v.* Cuthbertson, 6 Ga. 166.

as if he were the agent of a natural person unless the charter expressly provides otherwise.[1] Should an agent of a corporation having authority to execute a mortgage and affixes to one he executes anything which the law recognizes as a seal when affixed by a natural person, it will be presumptively a good execution by the corporation.[2] A contract in writing may be binding on a corporation though a private seal of one its officers be used instead of the corporate seal, and though no record may be found authorizing the officer to make the contract if proven by other evidence that he had such authority or that the corporation ratified his act afterwards.[3] The authority of an agent to bind a corporation by a contract for borrowing money may be inferred from proof of the character of the agency, the acts of the agent and the knowledge of the officers and directors of his habit to make similar contracts and their acquiescence in the same and the fact of the money being applied to the use of the corporation.[4] Whatever the purpose of the agency, an agent of a corporation may be appointed without the use of a seal.[5] The appointment of an agent by a corporation may be inferred from the permission, or acceptance, of his services.[6] If one has long acted in the capacity of managing director of a corporation without objection, and his services as such have been invariably accepted, it matters not, as against strangers, whether or not he has received a specific appointment to such position from the directors.[7] It is not necessary that the authority be given by a formal vote in matters where the acts of the agent of a corporation in the transfer of personal property require no formal instrument under seal, as in the sale or mortgage of personal

[1] City of Covington *v.* Covington & Cincinnati Bridge Co., (1873) 10 Bush (Ky.), 69.

[2] Johnston *v.* Crawley, 25 Ga. 316.

[3] Eureka Company *v.* Bailey Company, (1870) 11 Wall. 488.

[4] Allen *v.* Citizens' Steam Navigation Co, 22 Cal. 28. In Savings Bank of New Haven *v.* Davis, 8 Conn. 201, it appeared that the directors of a corporation, by the charter, had the power of disposing of its property and of appointing such agents as should be requisite for performing its business, and that, by a vote entered upon their record book, they appointed an agent to execute a mortgage deed of real estate to secure a creditor. The appointment of the agent, though not otherwise evidenced or authenticated by the corporate seal, was held valid for the purpose intended. See, also, Beckwith *v.* Windsor Manufacturing Co., 14 Conn. 603.

[5] Fitch *v.* Lewiston Steam Mill Co., 80 Me. 34; s. c., 12 Atl. Rep. 732.

[6] Burgess *v.* Pue, 2 Gill (Md.), 254.

[7] Walker *v.* Detroit Transit R. Co., 47 Mich. 338; s. c., 11 N. W. Rep. 187.

property.[1] The authority of an agent of a private corporation to bind it by a contract for borrowing money may be shown without proof of a resolution of the managing board directly conferring the authority or of any formal ratification of the contract by such board. His authority may be inferred from proof of the character of the agency, of the acts of the agent or other knowledge of the officers and directors of such habit to make such contracts and their acquiescence in the same and the fact of the money being applied to the use of the corporation.[2] The authority to an agent of a corporation to contract in its behalf, either under seal or otherwise, need not be conferred at a meeting of the directors unless that is the usual mode of their doing such an act. Should the board adopt the practice of giving assent to the execution of contracts by their agents, assent so given is of the same force as if done at a regular meeting of the board.[3] Where an act of incorporation does not require that the appointment of an agent of the corporation shall be by written instrument, and it does not appear to have been so made, the appointment may be proved by parol.[4] It is not necessary to enter on the minutes of a corporation a vote or resolution of the directors appointing an agent. His appointment may be inferred from the permission or acceptance of his services by the corporation.[5] The appointment as well as the authority of an agent of a corporation may be implied from the adoption or recognition

[1] Fitch *v.* Lewiston Steam Mill Co., 80 Me. 34; s. c., 12 Atl. Rep. 732. As to formally authorizing the acts of officers being or not being necessary, see Calvert *v.* Idaho Stage Co., (1894) 25 Or. 412; s. c., 36 Pac. Rep. 24; Brown *v.* Grand Rapids Parlor Furniture Co., 58 Fed. Rep. 286; s. c., 7 C. C. A. 225; Burch *v.* Paper Co., 141 Ill. 519; s. c., 31 N. E. Rep. 420.

[2] Allen *v.* Citizens' Steam Navigation Company, (1863) 22 Cal. 28.

[3] Bank of Middlebury *v.* Rutland & Washington R. R. Co., 30 Vt. 159; Stark Bank *v.* U. S. Pottery Co., 34 Vt. 144; State ex rel. Page *v.* Smith, 48 Vt. 266. As to appointment of agents of corporations by parol, see Jhons *v.* People, 25 Mich. 499; Taymouth *v.* Koehler, 35 Mich. 22. As to proving by parol evidence their official capacity, see Cahill *v.* Kal. Mut. Ins. Co., 2 Douglass (Mich.), 124; Druse *v.* Wheeler, 22 Mich. 439.

[4] Hamilton *v.* New Castle & Danville R. R. Co., (1857) 9 Ind. 359; Richardson *v.* St. Joseph Iron Co., 5 Blackf. (Ind.) 146; Madison *v.* Ross, 3 Ind. 236 Cincinnati, etc., Co. *v.* Clarkson, 7 Ind. 595; Jones *v.* Milton, etc., Co., 7 Ind. 547.

[5] Burgess *v.* Pue, 2 Gill (Md.), 254; Warren *v.* Ocean Insurance Co., 16 Me. 439; Jones, Admr., etc., *v.* Trustees Florence Wesleyan University, 46 Ala. 626; State Bank *v.* Comegys, 12 Ala. 772.

of his acts by the corporation.[1] So, also, from the course of dealing and from contemporaneous and subsequent acts on the part of the corporation.[2] An agent of a corporation will not be personally liable upon a contract in his own name under seal with another person where, in the body of the contract, it is stated that the agent contracted in behalf of the body corporate.[3]

§ 115. Rules as to an agent's acts.— The power of an agent of a corporation, unless otherwise shown, will be limited to the business of the corporation, connected with or relating to the object and design of the charter of the corporation.[4] And he can only make such contracts as the corporation can lawfully make.[5] If the acts of an agent of a corporation are some within, and some beyond, the corporate powers, the corporation may ratify his acts so far as they were within its powers.[6] Agents of a corporation are not required, by any rule of the common law, to act by deed in behalf of their principals, where they might act themselves by parol.[7] Though not reduced to writing, their contracts bind a corporation.[8] Wherever a corporation is acting within the scope of the legitimate purposes of its institution, all parol contracts made by its authorized agents are express promises of the corporation; and all the duties imposed on them by law, and all benefits conferred at their request, raise implied promises, for the enforcement of which an action will lie.[9] The acts of agents of corporations, within the ordinary line of their duty, bind corporations without any formal vote.[10] The name of the corporation as

[1] Kiley *v.* Forsee, (1875) 57 Mo. 390; Southgate *v.* Atlantic & Pacific R. R. Co., (1875) 61 Mo. 89. As to implying an agency for a corporation from facts and circumstances, see Northern Central Ry. Co. *v.* Bastian, 15 Md. 494.

[2] Washington Mut. Fire Ins. Co. *v.* St. Mary's Seminary, (1873) 52 Mo. 480.

[3] McDonough *v.* Templeman, 1 H. & J. (Md.) 156.

[4] Pennsylvania, Del. & Maryland Steam Navigation Co. *v.* Dandridge, 8 G. & J. (Md.) 248.

[5] Downing *v.* Mount Washington Road Co., 40 N. H. 230.

[6] Bangor Boom Corporation *v.* Whiting, (1848) 29 Me. 123.

[7] Buncombe Turnpike Co. *v.* McCarson, 1 Dev. & Bat. (N. C.) 306.

[8] City Bank of Baltimore *v.* Bateman, 7 H. & J. (Md.) 104; Union Bank *v.* Ridgely, 1 H. & G. (Md.) 326.

[9] Bank of Columbia *v.* Patterson, 7 Cranch, 299, 306; Eastman *v.* Coos Bank, 1 N. H. 23; Smith *v.* Nashua & Lowell Railroad, 27 N. H. 86; Glidden *v.* Unity, 33 N. H. 571; Great Falls Bank *v.* Farmington, 41 N. H. 33; Andover *v.* Kendrick, 42 N. H. 324.

[10] Foot *v.* Rutland & Whitehall R. R. Co., 32 Vt. 633. As to acts of

the contracting party should be in the body of the contract, where an agent would bind the corporation only in making a contract in its behalf, and the agent should sign it as agent or officer.[1] A committee appointed by a corporation, having made a settlement of matters between the corporation and third parties, and it appearing that the corporation had received the check of the third party from its committee, it has been held was sufficient to justify the trial court in submitting the question of ratification of the committee's action by the corporation to the jury.[2] An attorney at law representing a corporation in a suit in the courts, must have special authority to compromise the same. But, in case he makes such a compromise, the facts of which may be known to the officers of the corporation intrusted with its affairs, and they frequently advise with the attorney about the matter, and make no objection to it, and the corporation accept the benefit of the compromise, as by receiving the money agreed to be paid it, this would amount to a ratification of the attorney's acts.[3] Authority to give a negotiable promissory note for the amount advanced is not included in an authority to advance money for a corporation.[4] A corporation will not be bound by the acts or knowledge of one of its officers in a matter in which he acts for himself and deals with the corporation as if he had no official relations with it.[5]

§ 116. To what the powers conferred on agents may be extended.— The authority to give to the lender of money bor-

agents of corporations being done in the line of such agency in order to bind the corporations, see Queen *v.* Second Ave. R. R. Co., (1872) 35 N. Y. Super. Ct. 154. There can arise no presumption that an agent has authority to transact business, which the corporation is not authorized by its charter to engage in. Alexander *v.* Cauldwell, (1881) 83 N. Y. 480. As to corporations being bound by the acts of their agents made in the ordinary discharge of their duty, though not authorized, or executed, under corporate seal, see Mechanics' Bank *v.* Bank of Columbia, 5 Wheat. 326; Fanning *v.* Gregoire, 16 How. 524; Bank of Metropolis *v.* Guttschlick, 14 Pet. 19; Bank of U. S. *v.* Dandridge, 12 Wheat. 67; Bank of Columbia *v.* Patterson, 7 Cranch, 299; Fleckner *v.* U. S. Bank, 8 Wheat. 339.

[1] Hamilton *v.* New Castle & Danville R. R. Co., (1857) 9 Ind. 359; Hankins *v.* Shoup, 2 Ind. 342.

[2] Merchants' Union Barb Wire Co. *v.* Rice, (1886) 70 Iowa, 14; s. c., 28 N. W. Rep. 494.

[3] Wetherbee *v.* Fitch, (1886) 117 Ill. 67; s. c., 7 N. E. Rep. 513.

[4] Webber *v.* Williams College, (1839) 23 Pick. 302.

[5] Platt *v.* Birmingham Axle Co., (1874) 41 Conn. 255.

rowed, or to the seller of things purchased, the ordinary securities of a corporation is included in a general power conferred upon an agent of a railroad corporation to borrow money on its behalf, in such sums, for such length of time and at such a rate of interest as he may think proper, and to purchase iron rails, locomotives, machinery, etc., as he may deem advisable, and, in order to do so, to make, execute and deliver obligations, bills of exchange, contracts and agreements of the corporation.[1] And the authority from a corporation to an agent to give a company "note" has been held to authorize drawing a bill of exchange on a person who had no funds, and where the company would not by law be chargeable with damages on dishonor.[2] While a factor employed by the general agent of a corporation to sell its manufactured goods and to purchase stock has power to buy on credit, he is not authorized to give the note of the corporation for the purchases he makes on its account.[3] An agent of a manufacturing corporation was empowered by its by-laws to manage the affairs of the corporation committed to his care, and to exercise the powers committed to him according to his best ability and discretion, and promptly to collect all assessments and other sums that should become due to the corporation, and to disburse them according to the order of the board of directors, who were made a board of control over him. The Supreme Court of Judicature of Massachusetts held that the agent, the board of directors not interposing to control his proceedings, had authority to employ workmen to carry on the business of the corporation, and to pay them with its funds, or, not being in funds, to give the notes of the corporation in payment.[4] An agent of an incorporated manufacturing company, authorized by its by-laws to raise money and create liability on its part, may also waive demand and notice on a note indorsed by such company, and this, too, after the note has been negotiated. He may waive demand and notice to procure delay of payment of the note and bind the corporation, although, in procuring delay, he may also be the agent of the maker. And the fact that he agreed to pay more than the legal rate of interest for such delay would prevent a recovery against

[1] Hatch *v.* Coddington, (1877) 95 U. S. 48.

[2] Tripp *v.* Swanzey Paper Co., (1832) 13 Pick. 291.

[3] Emerson *v.* Providence Hat Manufacturing Co., (1815) 12 Mass. 237.

[4] Bates *v.* Keith Iron Co., (1843) 7 Met. 224.

the company, upon their indorsement, of the amount legally due.[1]

§ 117. Illustration of the binding force of an agent's acts.— In a New York case it appeared that the president of a Pennsylvania corporation, a coal company, was, during all the time of the transactions involved in the action, the actual manager of the business of the corporation, and, with the nominal treasurer of the corporation, owned all its stock, except a few shares held by persons employed in the office of the company, sufficient to qualify them for directors, and thus to make and maintain a corporate organization. As president, he drew the drafts and indorsed the checks and other commercial paper of the company, and directed all the financial affairs of the corporation with the knowledge of the other directors and stockholders. The company's business, the sale of coal mined by them, for cash and on credit, at wholesale and retail, was quite large in one of the cities of New York. The president of the coal company addressed a letter to the president of a bank it that city informing him that a certain person was "the authorized agent of the [corporation] for the sale of its coal at [that city]," and then added: "Any paper he may take for coal sold for said company he is authorized to indorse as the agent of said company, and get it discounted at your [the Marine] bank, and that any and all such paper so indorsed which you may discount for him the said company will see paid.

"[Signed by] [his name], *President.*"

This was an action by the bank against the company on its indorsement of a number of these notes discounted by it, which were not paid by the makers, and for an overdraft made by this agent. The Supreme Court of New York, in General Term, sustained the conclusion of a referee in the suit awarding a recovery to the bank.[2]

[1] Whitney *v.* South Paris Manufacturing Co., (1855) 39 Me. 316.

[2] Marine Bank of Buffalo *v.* Butler Colliery Co., (1889) 52 Hun, 612; s. c., 5 N. Y. Supp. 291. *Arguendo*, it was said: "The notes were evidently discounted by the [bank], relying upon the apparent authority of Hubbell, the agent, to indorse them for the defendant. The letter [above quoted] gave the [bank] notice of [his] authority as agent of the defendant to sell its coal at Buffalo, to take notes for coal sold, to indorse such notes for the defendant and to procure their discount at the [bank]. The authority of [the writer] to write the letter and to bind the defendant thereby is clearly established by the undisputed evidence of the manner in which the business of the corporation was conducted. During all the years covered by the transactions in question the president of the corporation was permitted to be, and to hold himself out to the world as being, the general manager and director of its business. The act in question was within the scope of the authority thus practically accorded to him, and the defendant cannot set up its by-laws, never published to the world and habitually disregarded by itself, as countervailing the authority thus publicly conferred. Martin *v.* Niagara Falls Paper Manufacturing Co., (1887) 44 Hun, 130, 138; Martin *v.* Webb, 110 U. S. 7; s. c., 3 Sup. Ct. Rep. 428. That the notes were within the terms of the letter has been found by the referee on undisputed evidence. They were given for coal sold by the agent for the defendant. That some of them were taken in renewal of notes given when the coal was sold, does not change the character of the indebtedness, nor of the evidence of it. Moreover, the [bank] had a right to rely on the representations of the agent, not of the existence of his authority to procure discounts, but that the notes offered by him for discount were within the scope of that authority, and the [corporation] is estopped to deny that those representations were true. Bank of Batavia *v.* New York, L. E. & W. Railroad Co., 106 N. Y. 195; s. c., 12 N. E. Rep. 433. In that case the court says: 'It is a settled doctrine of the law of agency in this state that where the principal has clothed his agent with power to do an act upon the existence of some extrinsic fact necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, a third person, dealing with such agent in entire good faith, pursuant to the apparent power, may rely upon the representation, and the principal is estopped from denying its truth to his prejudice.' In this case the extrinsic fact that the notes were given for coal, upon which the authority of the agent depended, and which were solely within his knowledge, was represented not only by the presentation of the notes for discount, but by the repeated assurances of the agent that he never did and never should present notes of any other character. The fact that the indorsements were made in the name of E. S. Hubbell, agent of the Butler Colliery Company, and not in the name of the corporation by E. S. Hubbell, agent, though not strictly confined to the language of the authority, was within its spirit and intent, and was ratified by a long course of dealing on the part of the [corporation], with full knowledge of the manner in which the business was done, and with full enjoyment of the fruits of the transaction." A counterclaim on the part of the corporation for moneys received by the bank from the corporation's agent and afterwards drawn out and, as was alleged, misappropriated by him, was also disallowed by the referee below. The court said: "The same principles [applied to support this disallowance]. The authority of the agent to open and maintain the account with the [bank] and to draw against it for the purposes of his agency, being estab-

§ 118. Power of general agents.— A general agent of a corporation has power to direct and control its general business, to make contracts which will bind the corporation in the ordinary course of its business, and to borrow money for such purpose on

its credit.[1] But such a general agent, though clothed with the power to contract debts and borrow money on the credit of the corporation, has no power, in virtue of such an agency merely, to make a mortgage on the property of the corporation, real or personal.[2] An agent appointed by the directors of a corporation to superintend and carry on its business, has no power, as such agent, to pledge or mortgage the machinery used by the corporation for the security of a loan.[3] A director may act as the agent of a corporation, with the knowledge of the board, and independently of his duties as director, and his acts will bind the corporation.[4] Corporations may be bound by contracts of their general agents clearly within the scope of their employment, but no further.[5] The general agent of a corporation is not authorized to give its note for a debt due from a previous unincorporated company to which the corporation succeeded.[6] An agent of a corporation, performing the daily routine of his business, under the supervision and control of a board of directors, would not be authorized, as agent, to create a lien upon the entire property of the corporation to secure advances of money to it.[7] Managing officers of a corporation may, without an express delegation of power, or a formal resolution to that effect, employ attorneys to represent the corporation in litigation, or for counsel in its business affairs.[8] The general agent of a corporation organized for

lished by the letter of authority and the course of dealing between the parties, the [bank], in the absence of notice to the contrary, or of facts to put it upon inquiry, had the right to assume that the acts of the agent in this connection were what they purported to be, viz., in the execution of his power as agent. The [bank] was, therefore, entitled to credit for all moneys drawn by the agent in the ordinary course of the business and apparently within the scope of his authority as agent."

[1] Stokes *v.* New Jersey Pottery Co., (1884) 46 N. J. Law, 237.

[2] Stow *v.* Wyse, 7 Conn. 214; C. & N. R. R. Co. *v.* James, 24 Wis. 388.

[3] Despatch Line of Packets *v.* Bellamy Manufacturing Co., 12 N. H. 205.

[4] Holmes *v.* Board of Trade, (1883) 81 Mo. 137.

[5] Odiorne *v.* Maxcy, (1816) 13 Mass. 178.

[6] White *v.* Westport Cotton Manufacturing Co., (1822) 1 Pick. 215.

[7] Whitwell *v.* Warner, 20 Vt. 425. As to power of managing agents, see Stow *v.* Wyse, 7 Conn. 214, 219; Hawtayne *v.* Bourne, 7 Mees. & W. 595; Life & Fire Ins. Co. *v.* Mech. Fire Ins. Co., 7 Wend. 31; Knight *v.* Lang, 4 E. D. Smith, 381; Benedict *v.* Lansing, 5 Denio, 283; Torrey *v.* Dustin Monument Assn., 5 Allen, 329; Despatch Line of Packets *v.* Bellamy, 12 N. H. 205, 228; Luse *v.* Isthmus Transit Ry. Co., 6 Oreg. 122.

[8] Southgate *v.* Atlantic & Pacific R. R. Co., (1875) 61 Mo. 89.

purchasing timber land, converting the timber into lumber and selling it, and for carrying on a trading establishment, has an implied power from the nature of his business to give the negotiable note of the corporation in payment for labor in getting out such lumber.[1]

§ 119. When the authority of a general agent will not be implied.— A corporation engaged in a mining business in Michigan had its financial office in New York. Its general agent in Michigan was accustomed to indorse the company's paper for collection or discount, and to draw on the treasurer in New York for the current needs of the corporation, and his drafts were duly paid. He executed several notes in the name of the corporation. In an action upon these notes it was held by the Supreme Court of Michigan that a general agent, without being specially empowered so to do, had no authority to make notes in the name of his principal. Also that the facts stated above as to what he

[1] Tappan *v.* Bailey, (1842) 4 Met. 529. As to power of officers and agents to make contracts, see Blanding *v.* Davenport, I. & D. R. Co., (1894) Iowa, 55 N. W. Rep. 81; Curnan *v.* Delaware & O. R. Co., 138 N. Y. 480; s. c., 34 N. E. Rep. 201; National Cordage Co. *v.* Pearson Cordage Co., 55 Fed. Rep. 812; Huntsville Belt Line & M. S. Ry. Co. *v.* Corpening, (1892) 97 Ala. 681; s. c., 12 So. Rep. 295; Moore *v.* H. Gaus & Sons' Manufg. Co., (1892) 113 Mo. 98; s. c., 20 S. W. Rep. 975; Nichols *v.* Scranton Steel Co., 137 N. Y. 471; 33 N. E. Rep. 561; Teitig *v.* Boesman, 12 Mont. 404; s. c., 31 Pac. Rep. 371; Thompson *v.* Stanley, (N. Y. Super. Ct. Sp! T. 1892) 20 N. Y. Supp. 317; Chemical Nat. Bank *v.* Wagner, (Ky. 1894) 20 S. W. Rep. 535; Levey *v.* New York Central & Hudson River R. Co., 24 N. Y. Supp. 124; Humes *v.* Decatur Land Improvement & Furnace Co., (1893) 98 Ala. 461; s. c., 13 So. Rep. 368; Tuller *v.* Arnold, (Col. 1894) 33 Pac. Rep. 445; Reynolds & Henry Construction Co. *v.* Police Jury, 44 La. Ann. 863; s. c., 11 So. Rep. 236; Smith *v.* Car Heater Co., 64 Hun, 639; Glover *v.* Lee, (1891) 140 Ill. 102; s. c., 29 N. E. Rep. 680; Matson *v.* Alley, (1892) 141 Ill. 284; s. c., 31 N. E. Rep. 419, affirming 41 Ill. App. 72; Hamm *v.* Drew, 83 Tex. 77; Johnson *v.* Switch Co., 59 N. Y. Super. Ct. 169; Koch *v.* Association, 137 Ill. 497; s. c., 27 N. E. Rep. 530; Bank of Attica *v.* Manufg. Co., 49 Hun, 606; Bank of Yolo *v.* Weaver, (Cal. 1893) 31 Pac. Rep. 160; Tradesmen's Nat. Bank *v.* Lumber Co., 64 Hun, 635. That officers of a corporation are special and not general agents of the corporation, and their powers being limited by the charter and by-laws, see Adriance *v.* Roome, 52 Barb. 399. As to their power to bind it within the scope of their authority, see Alexander *v.* Brown, 9 Hun, 641. As to power of an agent of a joint-stock corporation formed under the laws of Connecticut, see Wood *v.* Wiley Construction Co., (1887) 56 Conn. 87; s. c., 13 Atl. Rep. 137.

was accustomed to do in the business could not imply authority in him to make such notes.[1]

§ 120. Power of officers generally.—Where persons are named in the statute of incorporation who may bind the corporation, no others can act as the agents of the corporation in the particulars designated in the statute.[2] While the records of a corporation are the best evidence as to who its officers are, it may be shown by parol that one was an agent of the corporation and what his duties as such were.[3] Powers may be conferred upon

[1] New York Iron Mine *v.* First National Bank of Negaunee, (1878) 39 Mich. 644. COOLEY, J., in the opinion, said upon the subject: "It was not disputed by the defense that the corporation had power to make the notes in suit. The question was whether it had in any manner delegated that power to [its general agent]. We cannot agree with the plaintiff that the mere appointment of general agent confers any such power. * * * In McCullough *v.* Moss, 5 Denio, 567, the subject received careful attention, and it was held that the president and secretary of a mining company, without being authorized by the board of directors so to do, could not bind the corporation by a note made in its name. Murray *v.* East India Co., 5 B. & Ald. 204; Benedict *v.* Lansing, 5 Denio, 283, and The Floyd Acceptances, 7 Wall. 666, are authorities in support of the same view. The plaintiff, then, cannot rest its case on the implied authority of the general agent; the issuing of promissory notes is not a power necessarily incident to the conduct of the business of mining, and it is so susceptible of abuse, to the injury, and indeed, to the utter destruction, of a corporation, that it is wisely left by the law to be conferred or not as the prudence of the board of directors may determine." See, also, Tripp *v.* Swanzey Paper Co., 13 Pick. 293; Union Gold Mining Co. *v.* Rocky Mountain Nat. Bank, 1 Colo. 531; 2 Colo. 565, 570; In re German Mining Co., 19 E. L. & E. 599; Hawtayne *v.* Bourne, 7 M. & W. 595; Carpenter *v.* Biggs, 46 Cal. 91; Lawrence v. Gebhard, 41 Barb. 575; Sewanee Mining Co. *v.* McCall, 3 Head, 619; Silliman *v.* Fredericksburg, O. & C. R. R., 27 Gratt. 120; Emerson *v.* Providence Hat Co., 12 Mass. 237; Hammond *v.* Michigan State Bank, Walk. Ch. (Mich.) 214; Grover & Baker Sewing Machine Co. *v.* Polhemus, 34 Mich. 247, 249; Reynolds *v.* Continental Ins. Co., 36 Mich. 131; Lyell *v.* Sanbourn, 2 Mich. 109; Marquette & Ontonagon R. R. Co. *v.* Taft, 28 Mich. 289; Kal. Nov. Mfg. Co. *v.* McAlister, 36 Mich. 327. As to corporations authorizing agents to make or indorse notes, see Olcott *v.* Tioga R. R., 40 Barb. 179; Melledge *v.* Boston Iron Co., 5 Cush. 158; White *v.* Westport Cotton Mfg. Co., 1 Pick. 215, 219; Odiorne *v.* Maxey, 13 Mass. 178; Kelly *v.* Fall Brook Coal Co., 4 Hun, 261; Sedgwick *v.* Lewis, 70 Pa. St. 217; Pahlman *v.* Taylor, 75 Ill. 629; Bird *v.* Daggett, 97 Mass. 494; Bridgeport City Bank *v.* Empire Stone Dressing Co., 30 Barb. 421; Central Bank *v.* Empire Stone Dressing Co., 26 Barb. 23.

[2] Landers *v.* Frank St. Meth. Epis. Ch. of Rochester, 97 N. Y. 119.

[3] Leckins *v.* Nordyke & Marmon Co., (1885) 66 Iowa, 471; s. c., 24 N. W. Rep. 1.

the officers of a corporation by a course of conduct of the corporation with its officers and the public which they would not have as such officers but for the usages of the corporation.[1] A corporation will be bound by the acts of one of its officers performed at his office, and where they have been numerous and long continued this justifies a presumption that they were done under instructions of the managers of the corporation.[2] Courts of equity will not interfere with the actions of officers of corporations who may be vested with discretionary powers by statute to correct mere errors of judgment, the power conferred not having been illegally nor unconscientiously executed.[3] One owning a majority of the stock of a corporation cannot act for the corporation in selling leases, for instance, that it may own, unless specially authorized, as a corporation can only act through its officers or by expressly delegating power to others.[4] One openly and notoriously exercising the functions of a particular agency of a corporation will be presumed to have sufficient authority from the corporation to so act.[5] The authority of an officer of a corporation to make a contract in its behalf may be inferred from the fact of the corporation's knowing that he is making such contract, and that it availed itself of whatever benefit arose from the contract.[6] A corporation will be liable upon contracts made by its officers and agents with other persons if these officers or agents, in their negotiations, so act as to induce the persons with whom they make such contracts to believe that they are acting for the corporation, notwithstanding the fact that they were in reality not acting for it.[7] Officers of a corporation have no power to bind the corporation as surety for their private debts.[8] A corporation will not be bound by the release of a debt given to a

[1] Winsor *v.* La Fayette County Bank, (1885) 18 Mo. App. 665.

[2] Beers *v.* Phœnix Glass Co., 14 Barb. 358.

[3] Philips *v.* Wickham, 1 Paige, 590.

[4] Hopkins *v.* Roseclare Lead Co., (1874) 72 Ill. 373.

[5] Singer Manufacturing Co. *v.* Holdfodt, (1877) 86 Ill. 455.

[6] Chicago Building Society *v.* Crowell, (1872) 65 Ill. 453, citing Bradley *v.* Ballard, 55 Ill. 413, 417; Buffit *v.* Troy & Boston R. R. Co., 36 Barb. 420; Abby *v.* Billups, 35 Miss. 618; Parish *v.* Wheeler, 22 N. Y. 494; Noyes *v.* R. & B. R. R. Co., 27 Vt. 111; Bissell *v.* M. S. & N. I. R. R. Co., 22 N. Y. 258; Perkins *v.* Portland, Saco & Portsmouth R. R., 47 Me. 590; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280, 289; Goodwin *v.* Union Screw Co., 34 N. H. 378.

[7] Wilson Sewing Machine Co. *v.* Boyington, (1874) 73 Ill. 534.

[8] Culver *v.* Real Estate Co., 91 Pa. St. 367.

debtor by one of its officers without authority.[1] A corporation cannot be bound by the act of an officer in a case where he professes to represent only himself and to deal with the corporation as if he had no official relation to it.[2] Under a resolution of the directors of a corporation, directing its officers to use certain notes in liquidating the liabilities of the corporation, the officers may give such notes as collateral security with the note of the corporation itself in payment of its debts.[3] The long usage of officers in issuing stock in exchange for the debt of a corporation for more than two years after the resolution of the board giving them the power had been rescinded, has been held to have implied an authority to make the exchange as effectually as an express resolution.[4] A corporation will not be bound by the declarations of its secretary as to the amount due on a mortgage held by it unless it be shown that the secretary had authority to bind it.[5]

§ 121. **The same subject continued.**— The president of a corporation will be authorized to purchase the materials to be used in the business of the corporation, and to borrow money for it and give its note for the money borrowed, by a vote of the directors clothing him with full power and control of its business.[6] Where a contract is one which the board of a corporation has power to authorize its president to make or ratify it after it has been made, the burden, if it is claimed to have been unauthorized, is on the corporation to show that it was not authorized or ratified by its board.[7] A manufacturing corporation cannot be

[1] Land Co. *v.* Sloan, 109 Pa. St. 532.

[2] Winchester *v.* Baltimore & Susquehanna R. R. Co., 4 Md. 231.

[3] Brookman *v.* Metcalf, 5 Bosw. 429.

[4] Lohman *v.* New York & Erie R. R. Co., 2 Sandf. 39.

[5] Johnston *v.* Building Association, 104 Pa. St. 394.

[6] Castle *v.* Belfast Foundry Co., 72 Me. 167. What is within the scope of the business intrusted to a president of a corporation. Seeley *v.* San José Independent Mill & Lumber Co., (1881) 59 Cal. 22. What kind of a transaction a board of directors or stockholders can sanction or ratify. Forbes *v.* San Rafael T. Co., 50 Cal. 340. As to a note signed by president and secretary, see Duggan *v.* Pacific Boom Co., (Wash. 1893) 34 Pac. Rep. 157. As to a president's authority, see Crowley *v.* Genesee Mining Co., 55 Cal. 273; Union Mut. Life Ins. Co. *v.* White, 106 Ill. 67.

[7] Patterson *v.* Robinson, (1889) 116 N. Y. 193; s. c., 22 N. E. Rep. 372; citing Bank of Vergennes *v.* Warren, 7 Hill, 91; Gillett *v.* Campbell, 1 Den. 520; Elwell *v.* Dodge, 33 Barb. 336; Chemical National Bank *v.* Kohner, 85 N. Y. 189, 193; Smith *v.* Hull Glass Co., 11 C. B. 897, 929; Lee *v.* Pittsburgh Coal & Mining Co., 56 How. Pr. 373; affirmed in 75 N. Y. 601. See, also, Patteson *v.* Ongley Electric Co., (1895) 87 Hun, 462; s. c., 34 N. Y. Supp. 209; citing Jourdan *v.* Railroad Co., 115 N. Y. 381; s. c., 22 N. E. Rep. 153; Oakes *v.* Water Co., 143 N. Y. 430; s. c., 38 N. E. Rep. 461.

bound by a contract of one who is a stockholder and director and overseer of part of its business, to aid in the extension of a railroad.[1] The treasurer of a savings bank, by virtue of his office merely, has no implied authority to transfer to a purchaser a promissory note belonging to the bank.[2] A vote of a newly-

[1] New Haven & Northampton Co. *v.* Hayden, (1871) 107 Mass. 525. As to authority of officers to make contracts, see Baker *v.* Harpster, 42 Kans. 511; s. c., 22 Pac. Rep. 415; Western Union Tel. Co. *v.* Yopst, 118 Ind. 248; s. c., 20 N. E. Rep. 222; Read *v.* Buffum, 79 Cal. 77; s. c., 21 Pac. Rep. 555; Eureka Iron Works *v.* Bresnahan, 60 Mich. 332; s. c., 27 N. W. Rep. 524; Merrill *v.* Consumers' Coal Co., 114 N. Y. 210; s. c., 21 N. E. Rep. 155.

[2] Holden *v.* Upton, (1883) 134 Mass. 177. As to what authority, *ex officio*, an officer has, see Farmers' Bank *v.* McKee, 2 Barr, (Pa.) 318; Hallowell & Augusta Bank *v.* Hamlin, 14 Mass. 178, 180; Crump *v.* United States Mining Co., 7 Gratt. 352. Where it would not be assumed that the treasurer of a board of trustees of a corporation had no authority to make an indorsement upon a note. Sayers *v.* First National Bank, (1883) 89 Ind. 230. In Blake *v.* Holley, 14 Ind. 383, it was held that a corporation might authorize its proper officer to assign a note by delivery, and perhaps it would be within the general powers of officers of a railway corporation to assign, in such manner as they might deem expedient, its choses in action. In Schallard *v.* Eel River Steam Navigation Co., (1886) 70 Cal. 144; s. c., 11 Pac. Rep. 590, it was held that a mortgage executed in the name of a corporation by its president and secretary and having the corporate seal attached, must be presumed to have been executed in pursuance of a due authorization to such officers, and the burden of proof was on the corporation to show the contrary. Also, that where the circumstances surrounding the execution of the mortgage showed the existence of proper resolutions of authorization and supported the presumption of its authoritative execution as shown by affixing the corporate seal, and the signatures of the proper officers, the mere fact that such resolutions did not appear in the proper book of the corporation was not sufficient to disprove their existence and invalidate the mortgage. See, also, Southern California Colony Association *v.* Bustamente, 52 Cal. 192–196. Where acts of officers and agents in making contracts have been held to bind the company. Powder River Live Stock Co. *v.* Lamb, (Neb. 1894) 56 N. W. Rep. 1019; Greig *v.* Riordan, 99 Cal. 316; s. c., 33 Pac. Rep. 913; Carrigan *v.* Port Crescent Imp. Co., 6 Wash. 590; s. c., 34 Pac. Rep. 148; Oro Mining & Milling Co. *v.* Kaiser, (1894) 4 Colo. App. 219; s. c., 35 Pac. Rep. 677. Agreement of officers that will bind a corporation. Outterson *v.* Fonda Lake Paper Co., 66 Hun, 629; s. c., 20 N. Y. Supp. 980. When a note signed by the president, secretary and two directors will be held to be the note of the corporation. In re Pendleton Hardware & Imp. Co., (1893) 24 Ore. 330; s. c., 33 Pac. Rep. 544. See, also, Reeve *v.* Bank, 54 N. J. Law. 208; Davis *v.* Lee Camp No. 1, C. V. (Va. 1894) 18 S. E. Rep. 839; Cross *v.*

formed manufacturing corporation contemplated the payment of royalties to and the purchase from an existing corporation in addition to tools and material of "all the other personal estate of said corporation, giving in payment therefor" a certain number of shares of stock in the new corporation to be issued to the president of the old corporation as trustee for the parties in interest, any balance of such shares remaining "after paying the liabilities" of the old corporation to be issued to the treasurer of the new corporation. A written contract, purporting to be made between the two corporations, was signed by their presidents, who were the principal creditors of the old corporation, by which the new corporation, in consideration of the transfer of all the stock, tools, materials and machinery of the old one, and of its agreement to license the new one under all its patents, agreed to pay, besides royalties, all the debts of the old corporation. No director or stockholder of the new corporation besides the president, knew anything of the particulars in which the contract departed from the terms of the vote. The Supreme Court of Massachusetts held, in an action on the contract, that there was no evidence for a jury of the authority of the president of the new corporation to make or sign the contract or of its ratification.[1] A corporation cannot be bound by a contract made by a promoter of the corporation in obtaining a subscription of stock before the organization of the corporation. But after its organi-

Anglo-American Banking Co. (1894) 79 Hun, 424; s. c., 29 N. Y. Supp. 960; Merchants & Farmers' Bank *v.* Hervey Plow Co., 45 La. Ann. 1214; s. c., 14 So. Rep. 139; Prindle *v.* Washington Life Ins. Co., 73 Hun, 448; s. c., 26 N. Y. Supp. 474; Prentice *v.* United States & Central American Steamship Co., 58 Fed. Rep. 702. Whether or not the acts of officers or agents bind the corporation. Stanley *v.* Sheffield, L. I. & C. Co., 83 Ala. 260; s. c., 4 So. Rep. 34; Whitaker *v.* Kilroy, 70 Mich. 635; s. c., 38 N. W. Rep. 606; Little *v.* Kerr, (N. J.) 14 Atl. Rep. 613; Templin *v.* Chicago, B. & P. R. Co., 73 Iowa, 548; s. c., 35 N. W. Rep. 634; St. Louis, Fort Scott & W. R. Co. *v.* Grove, 39 Kans. 731; s. c., 18 Pac. Rep. 958; Topeka Primary A. U. B. *v.* Martin, 39 Kans. 750; s. c., 18 Pac. Rep. 941; Griffith *v.* Chicago, B. & P. R. Co., 74 Iowa, 85; s. c., 36 N. W. Rep. 901; Merchants' Nat. Bk. of Chicago *v.* Detroit Knitting & Corset Works, 68 Mich. 620; s. c., 36 N. W. Rep. 696; New York, P. & N. Ry. Co. *v.* Bates, 68 Md. 184; s. c., 11 Atl. Rep. 705; Getty *v.* C. R. Barnes Milling Co., 40 Kans. 281; s. c., 19 Pac. Rep. 617; East Rome Town Co. *v.* Brower, 80 Ga. 258; s. c., 7 S. E. Rep. 273; Bank of Attica *v.* Pottier & Stymus Mfg. Co., 49 Hun, 606; s. c., 1 N. Y. Supp. 483.

[1] Bi-spool Sewing Machine Co. *v.* Acme Manufacturing Co., (1891) 153 Mass. 404.

zation the corporation may ratify it and be estopped from denying its liability upon such a contract.[1]

§ 122. Power of directors — general rules. — The directors have control of the ordinary management of a corporation.[2] But a corporation cannot be bound by the acts of individual directors.[3] A board of directors may, under their power to make by-laws, delegate their authority to a quorum composed of less than a majority of their number, notwithstanding a declaration in the charter of the corporation that its powers shall be exercised by a board of directors, consisting of a specified number.[4] A director who is permitted to act as such after he has sold all his stock in a corporation is a director *de facto*, and the proceedings of the board, in which he takes part, are valid as to third persons.[5] To bind a corporation by an express promise, the individual directors must be authorized; otherwise they have no power to bind it.[6] A corporation will be bound by the action of its directors, though acting separately, if in the usual sphere of directors.[7] The acts

[1] Joy *v.* Manion, 28 Mo. App. 55. See Fawcett *v.* New Haven Organ Co., 47 Conn. 226, as to the circumstances under which a contract made by a secretary and treasurer was held not to bind the corporation. When contracts made by officers are not binding on corporation. Banks *v.* New York Club, 68 Hun, 92; s. c., 22 N. Y. Supp. 727; Bank of New York *v.* American Dock & Trust Co., (1893) 70 Hun, 152; s. c., 24 N. Y. Supp. 406. For a full discussion on this subject, see Edwards *v.* Carson Water Co., (Nev. 1893) 34 Pac. Rep. 381. When authority of officers to indorse a note of the corporation is shown. National Bank of Battle Creek *v.* Mallan, (1887) 37 Minn. 404; s. c., 34 N. W. Rep. 901; First National Bank of Rock Island, Illinois, *v.* Loyhed, (1881) 28 Minn. 396; s. c., 10 N. W. Rep. 421; Farmers' Nat. Bank of Valparaiso, Ind., *v.* Sutton Manufacturing Co., (1892) 52 Fed. Rep. 191; s. c., 6 U. S. App. 312; 3 C. C. A. 1. As to corporations not being liable for debts contracted by the corporators before incorporation, see Hutchinson *v.* Surrey Consumers' Gas Light & Coke Association, 73 Eng. C. L. 689; White *v.* Westport Cotton Co., 1 Pick. 215; In re The Independent Assur. Co., 30 L. J. Rep. (Eq.) 222.

[2] Genesee County Savings Bank *v.* Michigan Barge Co., 52 Mich. 438; s. c., 17 N. W. Rep. 790; 18 N. W. Rep. 206.

[3] Lockwood *v.* Thunder Bay River Boom Co., 42 Mich. 537; 4 N. W. Rep. 292.

[4] Hoyt *v.* Thompson, 19 N. Y. 207.

[5] Wile & Brickner Co. *v.* Rochester & K. F. Land Co., (1893) 4 Misc. Rep. 570; 25 N. Y. Supp. 794. See, also, Despatch Line of Packets *v.* Bellamy Manufg. Co., 12 N. H. 205; In re Mohawk & H. R. Co., 19 Wend. 135.

[6] Workhouse *v.* Moore, 95 Pa. St. 408.

[7] Foot *v.* Rutland & Whitehall R. R. Co., 32 Vt. 633.

of a board of directors of a corporation, evidenced by a written vote, as completely bind the corporation, and are as complete authority to its agents, as the most solemn acts done under the corporation seal.[1] The power of directors to bind a corporation by their contracts may be exercised by a majority of the board. It is not necessary that all the doings of a board of directors should be entered on their records. The corporation will be bound by any verbal order or direction, in which a majority of the board concurs in relation to any matter of business intrusted to them.[2] An act purporting to be the act of a board of directors at a meeting of such board may be presumed to be the act of a majority of the board, unless shown to the contrary.[3] Other circumstances proving the consent of directors to a contract, it is not necessary, to bind the corporation, that the records of the board should disclose a formal vote of the directors.[4] The power placed by a charter in the directors cannot be limited by a by-law of a corporation.[5] A charter of a corporation providing that the president is entitled to all the powers and privileges of a director, and requiring seven directors to make a quorum, the president and six directors would constitute such a quorum.[6] In the absence of a special provision in a charter of a corporation upon the subject, less than a majority of the board of directors have no power to transact business. Their acts are absolutely void and the corporation cannot ratify them.[7] That it is provided in a charter of a corporation that a majority of the directors present at a regular meeting would be competent to decide on all business, is not a declaration that a minority of the directors, however small, may act as a board.[8] There is no power in the directors of a corporation to bind it by an agreement for extra

[1] Campbell *v.* Pope, (1888) 96 Mo. 468; s. c., 10 S. W. Rep. 187.

[2] Cram *v.* Bangor House Proprietary, (1835) 12 Me. 354 In Trott *v.* Warren, (1834) 11 Me. 227 it was held that a contract, made by a minority of a committee of a corporation, and not assented to by a majority, nor by the corporation, was not valid.

[3] Despatch Line of Packets *v.* Bellamy Manufacturing Co., 12 N. H. 205.

[4] Nashua & Lowell Railroad Co. *v.* Boston & Lowell R. R. Co., 27 Fed. Rep. 821.

[5] Union Insurance Co. *v.* Keyser, 32 N. H. 313; Campbell *v.* Merchants & Farmers' Insurance Co., 37 N. H. 35.

[6] Bank of Maryland *v.* Ruff, 7 G. & J. (Md.) 448.

[7] Price *v.* G. R. & I. R. Co., (1859) 13 Ind. 58.

[8] Ex parte Willcocks, 7 Cow. 402.

compensation, not made at a meeting of the board.[1] Directors of a bank, in case a deficit in the funds appears by the accounts of its cashier, have authority to make a settlement with such officer.[2] A corporation having power by its charter "to make contracts in writing, and signed by the president and secretary, or by such other officer or officers as the directors may appoint for that purpose," the directors may authorize the president alone to sign for the company. Proof of the formal vote of the directors giving him such authority is not necessary.[3] After seven years' acquiescence by a corporation in the lease of its property by its directors, something more must be shown than that it was executed in excess of the powers of the directors before the lessee will be required to surrender the profits he may have made upon it.[4]

§ 123. **Directors for the first year.**— The New York Court of Appeals has considered the objections to the validity of a mortgage executed by a manufacturing corporation formed under the statute of 1848 relating to such corporations, that the persons acting as a board of directors for the mortgagee were not, at the time of passing the resolution authorizing the mortgage, stockholders of the company, and were, therefore, not qualified under the statute to act as such directors. The court held the objection not tenable, and RUGER, Ch. J., for the court, *arguendo*, said: "The provisions of the statute (§ 3, chap. 37, Laws of 1848) requiring the stock, property and concerns of such company to be managed by directors who shall respectively be stockholders of the company, and who shall, except the first year, be annually

[1] Stoystown & Greensburg Turnpike Road Co. *v.* Craver. 45 Pa. St. 386.

[2] Frankfort Bank *v.* Johnson, (1844) 24 Me. 490.

[3] Topping *v.* Bickford, (1862) 4 Allen, 120. In Sampson *v.* Bowdoinham Steam Mill Corporation, 36 Me. 78, it was held that an action could be maintained against the corporation upon a document signed by its directors in that capacity certifying that the holder of it had previously advanced a specified sum of money for the corporation, under the authority given in its by-laws to the directors to manage all its prudential concerns.

[4] Pneumatic Gas Co. *v.* Berry, (1884) 113 U. S. 322; s. c., 5 Sup. Ct. Rep. 525. The court said: "A court of equity does not listen with much satisfaction to the complaints of a company that transactions were illegal which had its approval which were essential to its protection, and the benefits of which it has fully received. Complaints that its own directors exceeded their authority come with ill grace when the acts complained of alone procured its existence."

elected by the stockholders, do not apply to the original organization of a company formed under said act. The language of section 1 of the act, by express terms, makes the persons named in the certificate of incorporation as such, directors of the company for the first year of its existence, and confers upon such persons full power to act as directors in the performance of any corporate duty after the filing of such certificate. The corporate authority of such an organization must, from necessity, be coincident with the inception of its corporate existence, and antedate the acquisition by it of property, or the issue of stock certificates representing such property. It is conceded that the persons passing the resolution were those named as directors in the original certificate of incorporation, and the purchase of the property in question was one of the first official acts of the corporation; that the property thus purchased of the plaintiff furnished the basis of capital upon which their corporate stock was distributed, and that certificates for its entire amount in payment of such purpose were issued and delivered to the plaintiff simultaneously with the conveyance of the property to the corporation by him and the delivery to him of the mortgage. It is quite obvious that the statute cannot be made effective under any other interpretation, and it is a primary rule of construction to give some effect to the expressions of the legislative will, if consistent with a reasonable interpretation of its language. If its provisions be so construed as to require the existence of stockholders before there is a legal organization, it must necessarily defeat the creation of any corporation under it, as it is quite manifest that stock cannot be owned in a corporation which has itself no legal existence. The terms of the act providing for the appointment of directors for the first year do not require such an interpretation, and it is contrary to reason and settled rules of construction to ascribe to a statute such a meaning as will nullify its operation if it is capable of any other interpretation." [1]

§ 124. **Directors de facto.**—One who had been adjudged entitled to a premium on cattle exhibited at the fair of an agricultural society in Pennsylvania brought his action for its recovery. It appeared that certain directors of the corporation who had, in proceedings *quo warranto*, been adjudged not to be the legal

[1] Davidson *v.* Westchester Gas Light Co., (1885) 99 N. Y. 558, 565, 566.

officers, had offered these premiums, and the corporation defended on the ground that the acts of this board were not binding upon them, they not being directors *de jure*. The findings of the trial judge were that this board of directors "held the possession of the books of the corporation and the custody and control of its property, both personal and real. It was under their direction and management that the fair was held, and all purchases made for the purpose of holding the fair. They had custody also of all moneys paid as entrance fees, as well as all moneys received for admission. The premiums, for the recovery of which these suits were brought, were premiums offered by this board of directors." The judge held that the acts of the *de facto* directors were binding upon the corporation, which was affirmed by the Supreme Court.[1]

§ 125. **Illustrations of the power of directors.**— It is within the power of a board of directors of a manufacturing corporation, clothed with authority to manage its concerns, to authorize the agent of the corporation to raise money for his own use by

[1] Zearfoss *v.* Farmers & Mechanics' Institute of Northampton County, (1893) 154 Pa. St. 449; s. c., 26 Atl. Rep 211. In the opinion *per curiam* it was said: "Contracts entered into by a corporation *de facto* are binding after having been executed by either party. 2 Morawetz on Corp. §§ 750, 752. The act of an officer *de facto* is good whenever it concerns a third person who had a previous right or had paid a valuable consideration for it. Angell & Ames on Corp. (11th ed.) §§ 287, 286, 299. An officer *de facto* is one whose acts, though not those of a lawful officer, the law, upon principles of policy and justice, will hold valid, so far as they involve the interests of the public and third persons. State *v.* Carroll, 38 Conn. 449. Our own cases are to the same effect. Riddle *v.* County of Bedford. 7 S. & R. 386, 392; McGargell *v.* Hazleton Coal Co., 4 W. & S. 424–425. In the latter it was held that 'a corporation may act by means of an officer *de facto* as fully and effectually as regards the public and third persons as by an officer *de jure*,' in all matters within the scope of the corporation's ordinary business." To the contention that there is a distinction between *de facto* officers of public corporations and *de facto* officers of private corporations it was said: "While such a distinction appears to be recognized in some of the cases cited and relied on by [counsel], we are not convinced that it is sound. The weight of authority, in this country especially, is decidedly against it. In the case of public corporations, the reasons for holding the acts of *de facto* officers binding on the corporations they represent are doubtless stronger than in the case of private corporations; but, to some extent at least, they are the same in both, differing only in degree." As to a corporation being bound by the acts of its officers *de facto*, see Cahill *v.* Kal. Mut. Ins. Co., 2 Douglass, (Mich.) 124.

giving therefor a "company note," where this is intended as an advance or payment of the agent's wages.[1] Where full power to conduct the affairs of a corporation are by its charter vested in its president and directors, they have the right to authorize the president to indorse its notes.[2] The power to modify the terms of a guaranty of one corporation to another of a certain annual dividend on its capital stock, under an agreement between the two corporations, is in the directors and not in the stockholders of the corporation, and a court will not interfere in case the board exercise the power fairly and in good faith.[3] The custody of the assets of a corporation may properly be placed with a managing director, and if he is allowed by the corporation to hold himself out to the public as competent to dispose of its assets, the public are entitled to presume that he has authority to dispose of them.[4] There being power in corporate authorities, and generally the directors, to compromise corporate debts, they can release a part of a subscriber's liability in case there is doubt about it, for the purpose of securing the rest; and a compromise of that kind will bind the stockholders of any new corporation to which the property and rights of the existing corporation may be transferred, notwithstanding the fact that it cannot extinguish rights that have already been acquired by creditors.[5] In case there is no restraint by law or contract upon the power of the directors of a corporation, they may make any disposition of the profits of its business deemed by themselves to be judicious.[6] A completed contract between a corporation and an individual for the sale of stock by the individual to the corporation could not be proven by statements of individual directors out of a session of the board, and not accompanying any official act, and statements made by them in debate while in session.[7] The by-laws of a business corporation giving the directors authority to appoint a treasurer, they may do so without any formal meeting; and, there being no prohibition in the charter or by-laws, may agree with the treasurer as to his compensation.[8] All business of a corporation relating to

[1] Tripp *v.* Swanzey Paper Co., (1832) 13 Pick. 291.

[2] Merrick *v.* Trustees of the Bank of Metropolis, 8 Gill. (Md.) 64.

[3] Flagg *v.* Manhattan Ry. Co., 10 Fed. Rep. 413.

[4] Walker *v.* Detroit Transit R. Co., 47 Mich. 338; s. c., 11 N. W. Rep. 187.

[5] Whitaker *v.* Grummond, 68 Mich. 249; s. c., 36 N. W. Rep. 62.

[6] Park *v.* Grant Locomotive Works, 13 Stew. (N. J. Eq.) 114.

[7] Peek *v.* Detroit Novelty Works, 29 Mich. 313.

[8] Waite *v.* Mining Co., 37 Vt. 608; Waite *v.* Mining Co., 36 Vt. 18. As to contracts made by directors, see Fisher *v.* Gas Company, 1 Pears. (Pa.) 118; Martin *v.* Railway Co., 37 Leg. Int. 132.

the legitimate objects of its creation may be transacted by the directors without the sanction of the stockholders. Where it has under its charter the power to borrow money and secure the same by deed or lien on its real or personal property, or both, or borrowing money for the purpose of forwarding the objects of the corporation is among the ordinary duties of the board of directors, it follows that the board may secure the loan by deed or other lien. This is a part of the business transactions of a corporation which has always been regarded as within the province of the directors to perform.[1] The stockholders of a corporation would be estopped to deny the authority of its directors to borrow money and make a mortgage of the corporation's property to secure the loan, even if they were not authorized to do so, if they ratify the action of the directors in effecting the loan and mortgaging the property by approving the minutes of their proceedings before the loan is effected, and afterward receive the benefit of the loan and pay interest on it.[2] A railroad corporation may be bound by its directors under the powers usually conferred upon them to pay interest on stock subscribed until the completion of a portion of its road.[3]

§ 126. More illustrations on the same subject.—The Supreme Court of Colorado has held that a proposition by the officers of a private corporation to pay a party $5,000 in the stock of the company for his services, if he would procure a loan of $15,000 for the use of such corporation, or a proportionate amount of stock for a smaller loan, duly accepted and acted on, warranted the finding in this case of an agreement to pay such party, in the capital stock of the corporation, thirty-three and one-third per cent of any sum he could procure to be loaned it; also, that the officers acted in behalf of the corporation, although the president testified that the stock was to be furnished by the officers individually.[4] Directors authorized to receive subscrip-

[1] Wood *v.* Whelen, (1879) 93 Ill. 153.

[2] Aurora Agr. & Hort. Society of Aurora *v.* Paddock, (1875) 80 Ill. 263.

[3] Milwaukee & Northern Illinois R. R. Co. *v.* Field, 12 Wis. 340.

[4] Arapahoe Cattle & Land Co. *v.* Stevens, (1889) 13 Colo. 534; s. c., 22 Pac. Rep. 823. The court, in the opinion, discussed the question whether the contract was within the scope and authority of the officers making it and binding upon the corporation as follows: "As we have

tions for stock, payable "in such manner as the board of directors should direct," may receive payment in promissory notes.[1] Under the authority of the president and directors of a corporation to manage the affairs of the corporation they may make an

already seen, the corporation was organized for the purpose of buying and selling lands, horses, cattle, etc., also all other business incidental to stock raising. [The president and secretary] were general officers of the company, and must be presumed to have the powers usually conferred upon such officers. In addition to this, they were duly empowered to purchase the Gebhardt stock, etc., [for which purpose the money loaned was to be used], and this authority must be held to be as broad as the transaction. The power to purchase necessarily carried with it the power to obligate the company to pay, notwithstanding the fact that a by-law of the company forbade the contracting of any debt for the company except by order of the board of directors. Plaintiff was not a member of the company, and his rights cannot be affected by a by-law restricting the general powers of the officers of the company, of the existence of which by-law he is not shown to have had notice. Moraw. Priv. Corp. § 500; Ang. & A. Corp. 370, note a; Flint *v.* Pierce, 99 Mass. 68–70; Royal Bank of India's Case, L. R. (4 Ch.) 252; Maher *v.* City of Chicago, 38 Ill. 266." The question of the payment for services of the agent negotiating the loan in stock of the company also received the attention of the court in this case. They said, upon that question: "It is not necessary that shares in a corporation be paid for in cash. It has been held that the managing officers for a corporation may, in their discretion, issue full paid-up shares for real estate, labor and materials useful in carrying on the corporate business. In fact, such payment may usually be made in money or its equivalent, and, if in the latter, the transaction cannot be impeached for error of judgment on the part of the officers of the company as to the value of the services or property. Good faith and the exercise of an honest judgment meet the requirements of the law. Moraw. Priv. Corp. §§ 426, 429; Schenck *v.* Andrews, 57 N. Y. 133; Douglass *v.* Ireland, 73 N. Y. 100; Iron Co. *v.* Drexel, 90 N. Y. 87; Lorillard *v.* Clyde, 86 N. Y. 384. The [cases just cited] were all decided under the provisions of the act of 1853 of the state of New York, which act was amendatory to the provisions of a previous law of the state requiring that nothing but money should be received as payment for the stock of incorporated companies. By the amendment the trustees of such companies were authorized to purchase any property necessary for the corporate business, and in payment therefor to issue stock 'to the amount and value thereof.' Under this act it may now be considered as the settled doctrine in that state that the trustees, in taking property, must exercise their discretion, and that their judgment as to the value of the property, and the necessity for it will not be interfered with, in the absence of fraud. Thus it is said in Schenck *v.* Andrews, *supra:* 'They were the agents in behalf of the company, for that purpose, and the discharge of their duty called for the exercise of their discretion and judgment (having reference and due

[1] Magee *v.* Badger, 34 N. Y. 247.

order requiring payment of an installment on the stock.[1] A corporation cannot be held to have contracted unless by such agents or officers as have express or implied authority. Individual directors have no power whatever to bind a corporation.[2] A board of directors, when no express restraint appears to have been imposed upon it, may, in a case where a contract has been made between two corporations and circumstances indicate an inability on the part of one party to the contract to fulfill the terms of the agreement, compromise or adjust the matter between the two corporations on a basis dispensing with full and complete performance.[3]

§ 127. Illustrations of a lack of power in directors.— Directors of a corporation cannot delegate their authority or any portion of it requiring the exercise of judgment and discretion, unless, as conferred upon them, the authority includes the power of substitution in express terms, or by necessary implication.[4] Directors of a corporation have no authority to sell the stock of the corporation at a less sum than the price fixed in the charter.[5]

regard to the interests of those represented by them) in determining what should be bought, and the price to be paid therefor. It cannot be properly claimed, in giving a construction to the power conferred on them by the amendatory act, that the property purchased, and every part thereof, should be indispensable for the prosecution of the business of the company, or that the sum allowed therefor should be its precise, actual, intrinsic value (and that to be determined by a jury), for the exemption of a stockholder from the liability which the original act imposed, in case the whole capital was not actually paid in cash. Such a construction would defeat the evident object of the law, which clearly was to encourage the formation of companies by the appropriation of manufactories, mines and other property, proper for their business, and at a fair valuation, instead of money as a capital therefor. No person could be expected to become a stockholder and pay his money or appropriate his property, and he, nevertheless, be held liable to a contribution in favor of creditors, to the extent of the stock issued for such property, if a jury should subsequently, and at an indefinite and unlimited period thereafter, find that the trustees had, under a mistake, but in an honest exercise of their judgment, concluded erroneously either that the property was in fact, as disclosed by subsequent events, not absolutely indispensable, or actually worth the full sum allowed for it.'"

[1] Union Turnpike Co. *v.* Jenkins, 1 Caines, 381.

[2] Lockwood *v.* Thunder Bay River Boom Co., (1880) 42 Mich. 536, 539; adhered to in Hartford Iron Mining Co. *v.* Cambria Mining Co., (1890) 80 Mich. 491.

[3] People ex rel. Content *v.* Metropolitan Elevated Ry. Co., 26 Hun, 82.

[4] Gillis *v.* Bailey, 21 N. H. 150.

[5] Oliphant *v.* Woodburn Coal & Mining Co., (1884) 63 Iowa, 332; s. c., 19 N. W. Rep. 212. On this point, see

Neither can they accept property for a stock subscription at a price largely in excess of its value.[1] And a subscriber who received the shares for such property originally, or a transferee of such shares with notice, at the suit of any one injured thereby, may be compelled to make up the difference in value.[2] Directors of a corporation alone cannot increase the capital stock of a corporation unless expressly authorized. The general power to perform all corporate acts which they may have refers to the ordinary business transactions of the corporation, and does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock.[3] The subscriber to the stock of a railroad corporation cannot be released from his liability for his subscription by its directors.[4] It is not within the power of officers of a corporation to ratify an unauthorized act of their own.[5] No express promise of an individual director of a corporation, unless authorized, will bind the corporation.[6] A parol contract made by the directors of a bank is not binding on the corporation.[7] The stock of a member cannot be relieved by the president and directors of a corporation from forfeiture of its dividends by their advancing the money of the corporation to satisfy the conditions on which a forfeiture of dividends depends, as it is not in their power to do so.[8] The act of a president of a corporation, which the directors themselves have no authority to perform, cannot be ratified by the directors.[9] Where a charter, while giving the directors of a corporation the power to manage its stock, property and affairs, provides that the corporation should have the power to assess the stockholders in order to pay the corporation debts, its directors cannot exercise the power of assessment without authority from the corporation.[10] There is no power in a

Sturges *v.* Stetson, 1 Biss. 246; Fosdick *v.* Sturges, 1 Biss. 255; Mann *v.* Cooke, 20 Conn. 188; Fisk *v.* C., R. I. & P. R. Co., 53 Barb. 472, 513; O'Brien *v.* C., R. I. & P. R. Co., 53 Barb. 568; Neuse River Navigation Co. *v.* Commissioners, 7 Jones Law (N. C.), 275.

[1] Osgood *v.* King, 42 Iowa, 478.

[2] Jackson *v.* Traer, (1884) 64 Iowa, 469; s. c., 20 N. W. Rep. 764. See Bailey *v.* Pittsburg & Connellsville Gas, Coal & Coke Co., 69 Pa. St. 334; Boynton *v.* Hatch, 47 N. Y. 225; Tallmadge *v.* Fishkill Iron Co., 4 Barb. 382.

[3] Railway Co. *v.* Allerton, (1873) 18 Wall. 233.

[4] Bedford Railroad Co. *v.* Bowser, 48 Pa. St. 29.

[5] Hotchin *v.* Kent, 8 Mich. 526.

[6] Workhouse *v.* Moore, 95 Pa. St. 408.

[7] Hughes *v.* Bank of Somerset, (1824) 5 Litt. (Ky.) 45.

[8] Marine Bank *v.* Biays, 4 H. & J. (Md.) 338.

[9] Crum's Appeal, 66 Pa. St. 474.

[10] Marlborough Manufacturing Co. *v.* Smith, 2 Conn. 584.

simple director or vice-president of a railroad company, by virtue of his office, to appoint agents to sell the lands or the timber on them.[1] Without special authority, a director, as such, cannot make notes binding the corporation.[2] The directors of a railway corporation cannot give away its stock.[3] A committee of its directors, authorized by a railroad corporation to enter into a contract for the construction of its road, after the contract is executed, would have no power to modify the contract as originally made.[4] Directors, though they may compromise an existing claim, have no implied power to make new agreements radically modifying previous agreements which they did not make and had no power to make.[5] The directors of a corporation have no power to make a donation from, or misappropriate the funds of the corporation in violation of the laws and rules regulating its mode of action.[6]

§ 128. When notes will be held to have been authorized by a board of directors.— In a case in the federal court for the district of Kansas it was urged that certain notes issued by a railroad company were in violation of a by-law of the company, which prohibited the giving of notes, bonds, bills, acceptances, etc., by the company unless ordered by the board of directors. Foster, J., said upon this that "[one] note was made by positive order of the board of directors, and by the president and secretary, as therein directed. Some by-law of the company required notes to be made to the order of the president and secretary. This is a mere matter of form, and not material. The other notes were made [before the adoption of the by-law], and besides, the board of directors at their meeting [held nine months before their execution], directed that orders be drawn on the company for [their amount]. Orders are not notes, but that order of the board would, doubtless, have been good for acceptances, which stand on the same footing as notes under the by-laws."[7]

[1] Chicago & Northwestern R. Co. *v.* James, 22 Wis. 194.

[2] Lawrence *v.* Gebhard, 41 Barb. 575.

[3] Thornton *v.* St. Paul, etc., R. R. Co., 6 N. Y. Wkly. Dig. 309.

[4] Western R. R. Co. *v.* Bayne, 11 Hun, 166.

[5] Metropolitan Elevated Ry. Co. *v.* Manhattan Ry. Co., (Spl. Term Sup. Ct. 1884) 14 Abb. N. C. 103; s. c., 11 Daly, 373.

[6] Frankfort Bank *v.* Johnson, (1844) 24 Me. 490.

[7] Stewart *v.* St. Louis, Ft. S. & W. R. Co., (1887) 41 Fed. Rep. 736. In Wile

§ 129. Waiver by directors of their power to repudiate a contract.— The officers of a corporation being made subject by the by-laws of a corporation to its board of directors, provided the board elect to exercise such control, should the board for some length of time fail to repudiate a contract made by the superintendent and treasurer of the corporation, their failure so to act will be presumed to operate as a waiver of their power.[1]

§ 130. Power of trustees of a corporation.— The trustees of a corporation have authority to enter into contracts for the payment of money, under the corporate seal, in furtherance of

& Brickner Co. *v.* Rochester & K. F. Land Co., (1893) 4 Misc. Rep. 570; s. c., 25 N. Y. Supp. 794, where notes were given by the corporation to two of its directors in payment for property purchased from them, the resolution to purchase and to give the notes having been adopted at a directors' meeting when the vendors were present and were necessary to constitute a quorum, but they did not vote on the resolution, it was held that though the transaction was voidable as between the corporation and its directors, the notes so given were valid in the hands of a *bona fide* purchaser, who, before taking them, asked the corporation's secretary about them, and was informed that they had been authorized by the board of directors. The court distinguished People's Bank *v.* St. Anthony's Roman Catholic Church, 109 N. Y. 513; s. c., 17 N. E. Rep. 408, in that in that case it appeared affirmatively that the officers who signed the note acted separately and not at a meeting of the board, and that there was no corporate act as a basis of their authority so to do.

[1] Indianapolis Rolling Mill Co. *v.* St. Louis, F. S. & W. R. Co., 26 Fed Rep. 140. Affirmed in Indianapolis Rolling Mill *v.* St. Louis, Fort Scott & Wichita Railroad, (1887) 120 U. S. 256; s. c., 7 Sup. Ct. Rep. 542, in which case the Supreme Court of the United States said: "The rule of law upon the subject of the disaffirmance or ratification of the acts of an agent required that if they had the right to disaffirm it they should do it promptly, and if after a reasonable time they did not so disaffirm it, a ratification would be presumed. In regard to this it appears that the board, when notified of what had been done by their agents, did not disaffirm their action at that time, but that the act or resolution of disaffirmance was passed about two years after notice of the transaction, and that if the suit brought in this case can be considered as an act of disaffirmance, it came too late, as it was commenced some six months after they had knowledge of the release. It was stated in the somewhat analogous case of The Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 592, 'the authorities to the point of the necessity of the exercise of the right of rescinding or avoiding a contract or transaction as soon as it may be reasonably done after the party, with whom that right is optional, is aware of the facts which gave him that option are numerous. * * * The more important are as follows: Badger *v.* Badger, 2 Wall. 87; Harwood *v.* Railroad Co., 17 Wall. 78; Marsh *v.* Whitmore, 21 Wall. 178; Vigers *v.* Pike, 8 Cl. & Fin. 650; Wentworth *v.* Lloyd, 32 Beav. 467; Follansbe *v.* Kilbreth, 17 Ill. 522; s.

the business of the corporation.[1] A corporation may be bound by the contract of a board of trustees holding their office under a judicial decision declaring their title to the office. And the corporation will not be relieved from its liability by a subsequent reversal of this decision on appeal.[2] Under the law of California empowering the trustees of a corporation formed under the general laws of that state, to levy and collect, for the purpose of paying expenses incurred in the management of the corporation's business, assessments upon the capital stock of the corporation not to exceed five per cent of such capital stock, provided no previous assessment then remained unpaid or uncollected,[3] such trustees, where the expenses incurred in the management have largely exceeded ten thousand dollars, may levy and collect such assessments upon the stock as will pay those expenses, notwithstanding a by-law of the corporation limiting the amount of the indebtedness they may incur to ten thousand dollars.[4] It is not beyond the power of the trustees of a secret society vested with general power to manage its property, to lease the lodge room to another society for use one night in each week.[5]

§ 131. Power of officers of a corporation to employ attorneys.—Attorneys and counsellors may be employed by the managing officers of a corporation without any specific authorization to that effect by formal resolution of the board of directors.[6]

c., 65 Am. Dec. 691.' See, also, Gold Mining Co. *v.* National Bank, 96 U. S. 640; Law *v.* Cross, 1 Black, 533."

[1] Clark *v.* Farmers' Woolen Manufacturing Co., 15 Wend. 256.

[2] Ebaugh *v.* German Reformed Church, 3 E. D. Smith, 60.

[3] Pub. Laws Cal. 1864, 402.

[4] Sullivan *v.* Triunfo Gold & Silver Mining Company, (1866) 29 Cal. 585.

[5] Phillip *v.* Aurora Lodge, No. 104, I. O. G. T., (1882) 87 Ind. 505. See Miller *v.* Chance, 3 Edw. 399, where it was held that a mortgage executed by five of nine chosen trustees might be presumed to have been executed with the concurrence of a majority of the board. Under what circumstances an executive committee appointed by a board of trustees of a manufacturing corporation may make a contract, and their power to draw the money on checks issued in payment under such contract, see Sheridan Electric Light Co. *v.* Chatham National Bank, (1891) 127 N. Y. 517; s. c., 28 N. E. Rep. 467.

[6] Western Bank of Missouri *v.* Gilstrap, (1870) 45 Mo. 419. The Appellate Court of Missouri, in a case where one of the contentions was that no legal authority to prosecute the suit on behalf of the corporation was shown, said: "The law in this state is settled by a course of uniform adjudications that no formal resolution of the board of directors is prerequisite for the employment of counsel for a corporation. Western Bank *v.* Gilstrap, 45 Mo. 419; Southgate *v.* Railroad, 61 Mo. 89; Thompson *v.* School District,

§ 132. When officers may use bonds as collateral.—A manufacturing corporation having been placed in the hands of a receiver in South Carolina, the master having found certain bonds in the hands of creditors to have a priority of lien, and his report having been confirmed, application was made upon the ground of newly-discovered evidence which it was claimed would show that the resolutions of the board of directors authorizing the issue of these bonds did not authorize such use of them as had been made with these particular creditors for an opening and recommitting of the report of the master. Upon the merits of the application the trial judge said it must fail, and gave these reasons: "The purpose with which the bonds in question were issued is declared in the preamble of the resolutions authorizing them to be 'to provide commercial capital for the proper management of the business of the company.' This was to be accomplished by the sale of the bonds or by their use as collaterals. In the course of business it became necessary to raise money to buy cotton and to pay the employees of the mill or to stop. An application was then made to the bank * * * and the resident directors to advance

71 Mo. 495; Holmes *v.* Board of Trade, 81 Mo. 137. In the last case cited Judge HOUGH says: 'A contract for legal services may be made by the tacit or implied contract of the board of directors,' and in Thompson *v.* School District, *supra*, Judge SHERWOOD says: 'Of course, if we concede the power, without formal resolution, to employ an attorney, the usual results of such employment will follow as a necessary consequence.' The question in that case was whether the entry of the appearance of the corporation as a party defendant by attorney was duly authorized." President Mining & Milling Co. *v.* Coquard, (1890) 40 Mo. App. 40, 43. Merrill *v.* Consumers' Coal Company, (1889) 114 N. Y. 216, was an action of an attorney against a corporation to recover shares of its stock to which he alleged he was entitled for services for one year under a contract made with its president. It appeared that the corporation had from its organization employed attorneys by the year and paid them in its stock; that the contract had been made by the president, with the approval of the board of directors, and that plaintiff rendered the services called for by his contract with the knowledge of the directors. The New York Court of Appeals held that the evidence was sufficient to warrant a finding that the contract was approved of or acquiesced in by the directors. As to a president's authority or that of other officers to employ counsel, etc., see Potter *v.* New York Infant Asylum, 44 Hun, 367; Insurance Co. *v.* Oakley, 9 Paige, 496; Bank *v.* Bank, 10 Wall. 604; Root *v.* Olcott, 42 Hun, 536; Rider Life Raft Co. *v.* Roach, 97 N. Y. 378; Bridenbecker *v.* Lowell, 32 Barb. 9; Chemical Bank *v.* Kohner, 8 Daly, 530; Bank *v.* Butchers', etc., Bank, 26 How. Pr. 5; Hooker *v.* Eagle Bank, 30 N. Y. 86; Peterson *v.* Mayor, etc., 17 N. Y. 449; Mumford *v.* Hawkins, 5 Denio, 355.

the money needed, and to hold the bonds as collateral security until they could be sold outright. This arrangement was made and the money advanced, and the bonds deposited as collateral security with the bank and the resident directors. This * * * was done with the full knowledge and consent of the board of directors, and the money used to carry on the mill, and all this was done before the bonds were taken by * * * the principal moving creditor." He then refers to certain affidavits made in the case and said: "If true, then there has been no improper or unauthorized use of said bonds, and if they were not pledged by resolution of the directors duly assembled, the company, with their knowledge and approval or gratification [ratification?], have received the benefit of the money advanced on the said bonds, and the transaction, in law or equity, must stand as against the said company and all creditors."[1] The Supreme Court affirmed this judgment, referring to the action of the judge in these words: "There can be no doubt whatever that one of the purposes for which the bonds were issued was to raise money to continue the running of the mills, and there is quite as little that upon application [the creditors whose claims were preferred by the master] did advance largely for that very purpose. Debts were pressing, two of the directors were absent from the state, non-residents, and a majority, the other six, authorized, informally, it may be, these bonds to be held by [them] as collateral security for advances made by them, as was done in the case of other advances, and upon the faith of this transaction the advances were actually made and used to the relief of the company. Under these circumstances it seems to us that the circuit judge did not abuse his judicial discretion in holding [as he did]."[2]

§ 133. When the execution of a note is not authorized.—In a Nevada case, where the execution of a note by a president and secretary of a corporation was held to have been unauthorized, the Supreme Court further held that where information of such act was not communicated to the trustees as a board, the trustees could not be held to have ratified the act by reason of the knowledge of a majority thereof acquired while acting as

[1] Hubbard *v.* Camperdown Mills, (1887) 26 S. C. 581, 584; s. c., 2 S. E. Rep. 576.

[2] Citing Ketchum *v.* Duncan, 96 U. S. 659; Claflin *v.* South Carolina R. R. Co., 8 Fed. Rep. 118.

president and secretary; also that the fact that the secretary made out a statement of the debts of the corporation in gross was not sufficient to give the stockholders notice that an unauthorized note was included therein, so that by their inaction they should be held to have ratified it, or to be estopped to deny its validity.[1]

§ 134. Execution of promissory notes and transfer of choses in action.— Authority to execute and issue promissory notes of a corporation need not be expressly given to its officers by the by-laws of the corporation or by formal resolution of its board of directors.[2] Such authority may be inferred from the acquiescence of the corporation in or its recognition of the acts of its accredited officers in the regular course of the authorized business of the corporation.[3] A note executed by an agent of a manufacturing corporation will not be presumed to have been authorized by the corporation. To render such a note valid against the corporation the powers of the agent must be shown.[4] The officers of a corporation have no power to authorize the execution of a note as surety for another in respect to a matter having

[1] Edwards *v.* Carson Water Co., (Nev. 1893) 34 Pac. Rep. 381. See, also, Hotchin *v.* Kent, 8 Mich. 527; Dabney *v.* Stevens, 40 How. Pr. 344; Story Ag. § 243; Howell *v.* McCrie, 36 Kans. 652; s. c., 14 Pac. Rep. 257; Combs *v.* Scott, 12 Allen, 496; Mallory *v.* Mallory Wheeler Co., 61 Conn. 141; s. c., 23 Atl. Rep. 708; Despatch Line of Packets *v.* Bellamy Mfg. Co., 12 N. H. 205, 232; Lyndon Mill Co. *v.* Lyndon Literary & Biblical Inst., 63 Vt. 581; s. c., 22 Atl. Rep. 577; Owings *v.* Hull, 9 Pet. 629; Bohm *v.* Brewery Co., (1890) 16 Daly, 80; s. c., 9 N. Y. Supp. 515; Murray *v.* Lumber Co., 143 Mass. 250; s. c., 9 N. E. Rep. 634; Fitzhugh *v.* Land Co., 81 Tex. 310; s. c., 16 S. W. Rep. 1078; Dedham Institution for Savings *v.* Slack, 6 Cush. 408, 411. The Nevada court in Edwards *v.* Carson Water Co., *supra*, give this as their understanding of the law upon this subject: "That before an individual or corporation can be held to have ratified the unauthorized acts of his or its agents, every detail of the transaction must have been made known to the principal. If, after obtaining such knowledge, the principal fails to act, long and continued silence will be deemed an approval of the act, and such ratification relates back and is equivalent to a prior authority to make the contract." Citing 1 Dan. Neg. Inst. §§ 316–319; Stark Bank *v.* United States Pottery Co., 34 Vt. 144, 146; Story on Agency, § 239; Bank *v.* Jones, 18 Tex. 816; Smith *v.* Tracy, 36 N. Y. 79, 82; French *v.* O'Brien, 52 How. Pr. 394, 398; Combs *v.* Scott, 12 Allen, 493, 497. See, also, Yellow Jacket Silver Mining Co. *v.* Stevenson, 5 Nev. 224, 228; Hillyer *v.* Overman Silver Mining Co., 6 Nev. 51, 55.

[2] First National Bank of Hannibal *v.* North Missouri Coal Co., (1885) 86 Mo. 125.

[3] Ibid.

[4] Benedict *v.* Lansing, 5 Denio, 283; Lawrence *v.* Gebhard, 41 Barb. 575.

no relation to the corporate business, and in which the corporation has no interest.[1] Such a transaction is not within the scope of its business; and a party receiving such note with notice of the circumstances under which it is given cannot recover on it.[2] A corporation may authorize its proper officer to assign a note by delivery.[3] The authority of an agent of a corporation to indorse a note may be shown by other evidence than the by-laws, as for instance, that a president and treasurer of the corporation was in the habit of negotiating notes of the corporation with the sanction of its finance committee.[4] An agent of a corporation may have authority to transfer a note by indorsement but has no authority to bind the corporation as indorser.[5] Express authority from a board of directors of a corporation is not necessary to enable its managing agent, to whom has been intrusted the management of the affairs of the corporation, to assign the choses in action belonging to it to its creditors, either in payment of, or as security for, the payment of a precedent debt.[6] Officers of a corporation, within their general powers, may assign its choses in action in such manner as they may deem expedient.[7] A corporation, it seems, would be bound by an assignment of its dues without recourse by one of its officers intrusted with the collection of its debts upon receiving the amount.[8]

§ 135. Notes signed by officers of a corporation.— Gilbert, United States Circuit Judge, in sustaining a demurrer to the defense in an action upon the promissory note of a corporation, that the president and secretary of the corporation had no authority from the corporation, either by by-law or resolution, to execute the note, and that the corporation received no benefit therefrom and did not ratify the same, declared these rules of law upon the questions involved, to wit: "The payee or indorsee of a negotiable promissory note, signed by the officers of a corporation as the note of the corporation, is not required to ascer-

[1] Hall *v.* Auburn Turnpike Company, (1865) 27 Cal. 255.

[2] Ibid.; Bank of Genesee *v.* Patchin Bank, 13 N. Y. 309.

[3] Blake *v.* Holley, (1860) 14 Ind. 383.

[4] Brown *v.* Donnell, (1860) 49 Me. 421.

[5] Ibid.

[6] McKiernan *v.* Lenzen, (1880) 59 Cal. 61; Gillett *v.* Campbell, 1 Denio, 522; Carey *v.* Giles, 10 Ga. 10; Phillips *v.* Campbell, 43 N. Y. 271.

[7] Blake *v.* Holley, (1860) 14 Ind. 383.

[8] Ætna Insurance Co. *v.* Wires, 28 Vt. 93.

tain whether the officers have authority to make the note. A corporation formed under the General Incorporation Laws for the purpose of conducting business has, so far as the law is concerned, the same power that an individual has to contract debts whenever necessary or convenient in furtherance of its legitimate objects. It may borrow money to pay its debts. It may execute notes, bonds and bills of exchange. The power to sign such paper may be conferred upon any officer. If the president and secretary sign, their authority is inferred from their official relation. All persons dealing with them have the right to assume that there is no restriction of that authority. They also have the right to assume, unless they have actual notice to the contrary, that a note so signed is made in the regular course of the business of the corporation. To hold otherwise would destroy the negotiability of all notes made by corporations."[1]

§ 136. Power of bank officers.— It is not sufficient to establish the official character of a person to designate him as an officer. There must be competent and official proof of his authority to act in an official capacity. Therefore, the assignment and acknowledgment of a judgment, purporting to have been made by a bank, in the absence of proof of the authority of the persons executing the assignment in the name of the bank, were held not sufficient to establish the fact of the assignment.[2] An assignment of the assets of a banking corporation under a resolution of its directory, for a purpose within the scope of their powers, is *prima facie* valid.[3] The settlement of a defalcation to a bank, and the acceptance of a deed of real estate in satisfaction and release, are not transactions which fall within the ordinary powers of a corporation which may be exercised by its agents or persons who are held out to the public as such. Power to do such acts must be conferred by the board of directors.[4] The president of the directory of a banking corporation cannot use its cash or credits,

[1] American Exchange National Bank *v.* Oregon Pottery Co., (1892) 55 Fed. Rep. 265; citing Merchants' Bank *v.* State Bank, 10 Wall. 644; Crowley *v.* Mining Co., 55 Cal. 273; 1 Dan. Neg. Inst. § 381.

[2] Klemme *v.* McLay, (1885) 68 Iowa, 158; s. c., 26 N. W. Rep. 53.

[3] Gibson *v.* Goldthwaite, (1845) 7 Ala. 281.

[4] Bank of Healdsburg *v.* Bailhache, (1884) 65 Cal. 327; Gashwiler *v.* Willis, 33 Cal. 11; Blen *v.* Bear River Co., 20 Cal. 602.

etc., for the purpose of settling the demands of its creditors, in the absence of authority conferred by its charter, by-laws or resolution of the directory within their power to adopt.[1] And the affixing of the seal of the corporation to an unauthorized transfer by its president of its assets cannot impart validity to the transfer.[2] The officers of a national bank, without express authority from its shareholders, after the bank goes into liquidation, can only bind them by acts implied by the duty of liquidation.[3] General authority, unrestricted by rules or by-laws, given to the president and cashier of a bank to manage and control all of its financial affairs, does not authorize them to use the property of the bank for private purposes of their own, or for the benefit of themselves; therefore, they cannot bind the bank by a contract to which they, or either of them, are parties.[4]

§ 137. Power of a bank cashier.— A cashier of a bank has no authority, by virtue of his office, to represent the bank at a meeting of the creditors of an insolvent, and to vote for syndic. A resolution of the board of directors can alone empower him to do so.[5] The cashier of a bank is held out to the world as its

[1] Gibson *v.* Goldthwaite, (1845) 7 Ala. 281. See Hallowell & Augusta Bank *v.* Hamlin, 14 Mass. 180.

[2] Gibson *v.* Goldthwaite, (1845) 7 Ala. 281. In Cross *v.* Anglo-American Banking Co., (1894) 79 Hun, 424; s. c., 29 N. Y. Supp. 960; 61 N. Y. St. Repr. 270, the president and chief executive of a foreign banking corporation having its principal place of business in the city of New York, being authorized by its articles of incorporation and by the action of its directors to open its office in that city, was held presumptively to have authority to purchase the furniture necessary to equip the office of the corporation, there being no by-law of the corporation or resolution of the directors limiting his power, or requiring that no expenditures should be made except under a resolution of the board of directors. In First National Bank of Whitehall *v.* Tisdale, (1881) 84 N. Y. 655, it was held to be beyond the power of a president of a national banking association to bind the association by an agreement to hold, without collecting, a note which had been indorsed to it at the president's request, for the purpose of increasing the bank's assets and enabling it to pass an expected examination of the inspector.

[3] Richmond *v.* Irons, (1887) 121 U. S. 27; s. c., 7 Sup. Ct. Rep. 788. In Schrader *v.* Manufacturers' National Bank of Chicago, (1890) 133 U. S. 67; s. c., 10 Sup. Ct. Rep. 238, it was held that the rights of the shareholders could not be affected by the acts of the president, done after the bank had gone into liquidation.

[4] Rhodes *v.* Webb, 24 Minn. 292.

[5] Reed *v.* Powell, (1845) 11 Rob. (La.) 98. The court said: "The directors are the general agents and administrators of the corporation, and by the charter are empowered to appoint such officers and sub-agents as may be necessary for the transac-

executive officer intrusted with its notes and bills, and the collection and transfer of them in the ordinary course of its business. And in case of promissory notes held by banks an indorsement by the cashier of the bank, in his official character, is sufficient, at least *prima facie* to pass the title of the bank thereto.[1] The cashier of a bank, in the course of his ordinary duties and by virtue of the general power appertaining to his office, has a right to transfer the paper securities of the bank, in payment of its debts.[2]

tion of its business. The powers and duties of these officers are defined by the charter and by-laws of the bank. Within the sphere of their respective duties they represent the corporation, and bind it by their acts; but in all matters and things not properly belonging to their office they cannot represent or act for the corporation unless specially or generally authorized so to do by a resolution of the board. Thus, the cashier, who is intrusted with the transaction of the banking business of the corporation, needs no special authority to do and perform any act required for the proper management and dispatch of the same; but when it becomes necessary for the corporation to appoint an agent for any particular purpose, or to do any other thing not properly belonging to the duties of his office, he has no better right to act than any other person. To say that he can make such an appointment, or do any other act on behalf of the corporation, because it is a mere act of administration, would be to make the cashier its general agent and administrator, instead of the board of directors." See, also, Union Bank *v.* Bagley, 10 Rob. (La.) 43; Clinton Company *v.* Kernan, 10 Rob. (La.) 176; Union Bank *v.* Jones, 4 La. Ann. 236.

[1] Haynes, Liquidator, *v.* Succession of Beckman, (1851) 6 La. Ann. 224; Fleckner *v.* United States Bank, 8 Wheat. 360; Wild *v.* Bank of Passamaquoddy, 3 Mason, 505, 507; Merchants' Insurance Co. *v.* Chauvin, 8 Rob. (La.) 49.

[2] Everett *v.* United States, (1837) 6 Port. (Ala.) 166. The court quoted the language of Mr. Justice STORY in Fleckner *v.* United States Bank, 8 Wheat. 358, as clearly recognizing the right of the cashier as stated in the text. That language was as follows: "The cashier is usually intrusted with all the funds of the bank, in cash, notes, bills, etc., to be used from time to time, for the ordinary and extraordinary exigencies of the bank. He receives directly or through the subordinate officers, all moneys and notes. He delivers up all discounted notes and other property, when payments have been duly made. He draws checks from time to time, for moneys, whenever the bank has deposits. In short, he is considered the executive officer, through whom, and by whom, the whole moneyed operations of the bank, in paying or receiving debts, or discharging or transferring securities, are to be conducted. It does not seem too much, then, to infer, in the absence of all positive restrictions, that it is his duty as well to apply the negotiable funds, as the moneyed capital of the bank, to discharge its debts and obligations." The cashier of a bank has no authority to pay a depositor in notes belonging to the bank by transferring them to him. Schneltman *v.* Noble, (1888) 75 Iowa, 120.

§ 138. When the authority of its cashier cannot be questioned by a bank.— Under the facts disclosed in a case before the United States Supreme Court, it was held by the court that the binding force of an agreement made by the cashier of the bank, in reference to the indebtedness of one of the debtors of the bank, including the cancellation of the debtor's old notes and trust deeds made by him to secure them and the acceptance of new ones could not be disputed by the bank.[1]

[1] Martin *v.* Webb, (1884) 110 U. S. 7. The ruling was based upon the principles stated by Mr. Justice HARLAN, speaking for the court, in these words: "It is quite true * * * that a cashier of a bank has no power by virtue of his office, to bind the corporation except in the discharge of his ordinary duties, and that the ordinary business of a bank does not comprehend a contract made by a cashier — without delegation of power by the board of directors — involving the payment of money not loaned by the bank in the customary way. United States Bank *v.* Dunn, 6 Pet. 51; United States *v.* City Bank of Columbus, 21 How. 356; Merchants' Bank *v.* State Bank, 10 Wall. 604. Ordinarily, he has no power to discharge a debtor without payment, nor to surrender the assets and securities of the bank. And, strictly speaking, he may not, in the absence of authority conferred by the directors, cancel its deeds of trust given as security for money loaned — certainly not, unless the debt secured is paid. As the executive officer of the bank, he transacts its business under the order and supervision of the board of directors. He is their arm in the management of its financial operations. While these propositions are recognized in the adjudged cases as sound, it is clear that a banking corporation may be represented by its cashier — at least where its charter does not otherwise provide — in transactions outside of his ordinary duties, without his authority to do so being in writing or appearing upon the record of the proceedings of the directors. His authority may be by parol and collected from circumstances. It may be inferred from the general manner in which, for a period sufficiently long to establish a settled course of business, he has been allowed, without interference, to conduct the affairs of the bank. It may be implied from the conduct or acquiescence of the corporation, as represented by the board of directors. When, during a series of years or in numerous business transactions, he has been permitted, without objection and in his official capacity, to pursue a particular course of conduct, it may be presumed, as between the bank and those who in good faith deal with it upon the basis of his authority to represent the corporation, that he has acted in conformity with instructions received from those who have the right to control its operations. Directors cannot, in justice to those who deal with the bank, shut their eyes to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. They have something more to do than, from time to time, to elect the officers of the bank, and to make declarations of dividends. That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known

§ 139. Indorsement of a draft by cashier and president.—An English corporation, a mortgage company, by its managers in an American city, drew drafts upon its home office in London and applied to a local bank to have them discounted. The latter signified that they would discount the drafts if they were indorsed by another local bank. This was done by the cashier and the president of the latter. Finally, one of these drafts was not paid at the home office of the corporation, and the discounting bank brought its action against the receiver of the other local bank upon the indorsement of the officers of that bank. The United States Circuit Court held that there could be no recovery.[1]

in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business."

[1] National Bank of Commerce of Kansas City *v.* Atkinson, (1893) 55 Fed. Rep. 465. The court thus states the contentions: "The defendant contends: First. That [the cashier] had no authority to place the indorsement of the [bank] upon those drafts, or either of them, and that * * * the president had no authority whatever to place the indorsement of the [bank] upon the first note, which was given after the drafts were protested, or any note representing these drafts. Second. That the indorsement, at most, was a loaning of the bank's credit, or, in other words, an accommodation indorsement, which the bank had no power to make." Then the question was discussed and the law stated as follows: "There is no doubt but what the law is that a national bank cannot loan its credit or become an accommodation indorser. On that question the decisions are uniform. It is also true that the president of a bank has no power inherent in his office to bind the bank by the execution of a note in its name, yet the power to do so may be conferred upon him by the board of directors, either expressly, by resolution to that effect, by subsequent ratification, or by acquiescence in transactions of a similar nature, and of which the directors have knowledge. In other words, I think it must be held that banks are liable for the acts of their officers, especially executive officers and general agents, within the general scope and apparent sphere of their duties; but that they are not liable for the acts of their officers done without special authority, in cases which are not within the general scope and sphere of their duties as such officers. The responsibility of a bank (in the absence of express authority to do a particular act) is limited to the acts of its officers and agents, performed in the discharge of their ordinary duties in the usual course of business and within the sphere and scope of such duties. Acts within the ordinary sphere and scope of their business are presumed to be by authority and within the knowledge of the directors. That there was no express authority given by the board of directors, by resolution or otherwise, either to * * * the cashier or to * * * the president, to indorse the drafts and notes, is conceded. Neither was there any formal ratification of their action by the directors or officers of the bank. Indeed, none of them had any knowledge whatever of the transactions except [these two officers]." The court then considered the facts upon the question of whether the bank retained and enjoyed the proceeds of these transactions, and thereby became liable by reason of its indorsement appearing upon those papers. In the course of the opinion it is said: "It is shown by the record beyond all question that the [bank] never received any benefit whatever, by way of discount or otherwise, out of the transactions in relation to these drafts, or either of them." And further on: "The [bank] never received any benefit from discounts or otherwise on these drafts. The renewal drafts and the notes were not placed upon the books of the [bank]. When the drafts were protested, the [bank] was not notified of the protest, but, on the contrary, the mortgage company only received notice of their dishonor. The notes were all indorsed in the office of the [plaintiff bank] by * * * the president [of the bank of which defendant is receiver], and away from the place of business of [this bank], and no mention of them was made upon its books. The directors of the bank did not know of their existence, and could not have ascertained their existence from an examination of the books or accounts of the bank. Such a transaction, it seems to me, cannot be said to be in the usual course of business, or within the implied powers of the president of a bank. My attention is especially called to the case of People's Bank *v.* National Bank, 101 U. S. 181. That was a case upon a guaranty. The papers passed through the bank in the regular course of business. The bank received the benefit of the transaction, and the officer of the bank was acting strictly within the scope of his authority as an officer of the bank. The facts in that case are different from the facts in the case at bar, and the decision, in my judgment, does not aid the plaintiff."

§ 140. Power of a treasurer of a savings bank.—The treasurer of a savings bank is not *virtute officii* clothed with power to borrow money for the institution and to pledge its securities as collateral.[1] The treasurer of a savings bank has no authority, *ex officio*, to release a debt due the bank, upon payment of a dividend by the debtor.[2] A vote of a savings bank corporation to sell notes held by it would not confer authority upon its treasurer to bind the bank by indorsing its name on a promissory note held by it, and he has no such authority *ex officio*.[3] A provision in the by-laws of such an institution that the treasurer "shall draw all necessary papers and discharge all obligations of the corporation, and his signature shall be binding on the corporation," has been held to mean the signature of the treasurer to necessary papers and in discharge of obligations to the corporation, and not to authorize him to bind the corporation by such an indorsement on a promissory note.[4] The title passes by an assignment of a

[1] Fifth Ward Savings Bank *v.* First National Bank, 19 Vr. (N. J.) 513.

[2] Dedham Savings Institution *v.* Slack, (1850) 6 Cush. 408.

[3] Bradlee *v.* Warren Savings Bank, (1879) 127 Mass. 107.

[4] Ibid.

mortgage in the name of a savings bank, executed by its treasurer who has authority to execute it, and his indorsement of the note to a *bona fide* holder, though he may in his action perpetrate a fraud upon the bank and convert the purchase money to his own use.[1]

§ 141. Power of officers of mining corporations.—It may be assumed by persons dealing with mining superintendents or general agents in charge of mines, in the absence of notice to the contrary, that their authority covers all the ordinary local business of a mining corporation.[2] The purchase of timber for a mining corporation is within the power of its general agent.[3] But such a general agent of a mining corporation, unless specially empowered so to do, has no authority to make promissory notes in the corporation's name.[4] The secretary of a mining corporation has no authority, by virtue of his office, to make assignment of the promissory notes belonging to the corporation. Such an assignment of notes by a secretary is not a corporate act unless it is shown that the secretary was not only authorized to make the transfer, but to make it in his official capacity.[5] The superintendent of a mining corporation, instructed by letters and otherwise from the officers of the corporation not to contract any debts, but merely to expend such money as might be furnished him, cannot bind the corporation by a promissory note.[6] There is,

[1] Whiting *v.* Wellington, 10 Fed. Rep. 810.

[2] Adams Mining Co. *v.* Senter, (1872) 26 Mich. 73.

[3] Ibid.

[4] New York Iron Mine *v.* Negaunee Bank, 39 Mich. 644.

[5] Blood *v.* Marcuse, (1869) 38 Cal. 590. For the same principles upon which this assignment was held to be void as not being a corporate act, see Gashwiler *v.* Willis, 33 Cal. 11; Marine Bank *v.* Clements, 3 Bosw. 600; Johnson *v.* Bush, 3 Barb. Ch. 207; Brown *v.* Weymouth, 36 Me. 415; Barcus *v.* Hannibal, Ralls County & P. P. R. Co., 26 Mo. 102; Mt. Sterling & Jeffersonville T. R. Co. *v.* Looney, 1 Metc. (Ky.) 550; Walworth County Bank *v.* Farmers' Loan & Trust Co., 14 Wis. 325; Hallowell & Augusta Bank *v.* Hamlin, 14 Mass. 180; Hoyt *v.* Thompson, 1 Seld. 320; Whitwell *v.* Warner, 20 Vt. 425.

[6] Carpenter *v.* Biggs, (1873) 46 Cal. 91. In New York Iron Mine *v.* Citizens' Bank, 44 Mich. 344; s. c., 6 N. W. Rep. 823, it was held that there was no presumption of authority of an agent of the mining corporation to draw post-dated bills of exchange on his principal from his having done so before without objection, there being nothing to show that the party relying on his authority knew the fact, and a long interval having passed since it occurred, and the corporation having meanwhile become prosperous and being better supplied with ready money; and it also appearing that the post-dated bills he had formerly drawn were drawn on time and post-dated only long enough to give the drawer the benefit of the full period of discount after receiving them, while in this case they were made payable at sight and post-dated several weeks for the agent's private advantage.

presumably, power in such an agent and manager of a mining corporation power to sell its personal property.[1]

§ 142. General rules as to the power of a president.—The powers of a president of a corporation over its business and property are strictly the powers of an agent.[2] A corporation will not be bound by the contract of its president, without proof of his agency.[3] The same evidence from which authority to bind would be inferred in other cases, must determine the authority of the president of the corporation to bind it by a contract entered into on its behalf.[4] It is necessary to show that an agreement of the president of a corporation is within the scope of his authority to make it evidence.[5] A corporation which, by its charter, can only act through its board of directors, cannot be bound by contracts entered into by its president, without the authorization of the board, except in acts of simple administration, which, of necessity, should be done without authorization.[6] A corporation cannot be bound by a contract made by its president, except it be shown that power to make it was given him by the act of incorporation, or that he was authorized by the corporation to make it, or that there was a subsequent ratification of the contract.[7] The power to sell and assign the securities of a corporation without authority from the trustees, is not included in the authority of its treasurer to collect and pay debts.[8] Acts of the corporation, or

[1] Scudder *v.* Anderson, 54 Mich. 122; s. c., 19 N. W. Rep. 775.

[2] State Bank *v.* Holcomb, 2 Hals. (N. J.) 196.

[3] Fisher *v.* Gas Co., 1 Pears. (Pa.) 118; Jackson *v.* Market Co., 12 W. N. C. (Pa.) 190.

[4] Lee *v.* Pittsburgh Coal & Mining Co., 56 How. Pr. 373; s. c., 75 N. Y. 601.

[5] Farmers' Bank *v.* McKee, 2 Pa. St. 318.

[6] Bright *v.* Metairie Cemetery Association, 33 La. Ann. 58.

[7] Mount Sterling & Jeffersonville Turnpike Road Co. *v.* Looney, (1858) 1 Metc. (Ky.) 550.

[8] Jackson *v.* Campbell, 5 Wend. 572. In Williams *v.* Uncompahgre Canal Co., (1889) 13 Colo. 469; s. c., 22 Pac. Rep. 806, it was held that where a contract under seal had been executed by the officers of a corporation in their individual names it was competent to aver and prove by parol that the corporation, as the real party in interest, adopted, ratified and undertook to carry out the terms of the contract in such a manner as to become bound thereby. Cases as to the lack of a president's power, unless it be specially conferred by the managing board:

acts of an authorized agent within the scope of his authority, from which the promise may be implied, must be shown to bind a corporation by an implied promise.[1] It is not in the power of the president of a corporation to borrow money in the name of the corporation and pledge its responsibility, without authority conferred by the charter or by-law of the corporation, or a resolution of the directors.[2] Under a by-law of a corporation giving the president "the general charge and direction of the business of the company, as well as all matters connected with the interests of the corporation," he has no authority to do an act which, by another by-law of the corporation, is expressly given to a separate committee.[3] A president cannot borrow money on his own note and bind the corporation for the loan by falsely representing that he wishes the money for his corporation.[4] The president of a corporation, having full personal charge of the business which the corporation was organized to transact, represents the corporation, and, *prima facie*, has power to do any act which the directors can authorize or ratify.[5] Unless authorized by the charter or by-laws of a corporation, its president has no authority to indorse and negotiate notes which are its property. But his authority to do so may be presumed from his uniform practice in such matters.[1] Under authority given him by the directors of a banking corporation to sell certain stock belonging to it, the president of the bank, where uninstructed to the contrary, would have authority to employ a broker to sell it.[2] The acts of clerks of a corporation in making unauthorized purchases for the corporation on credit may be ratified by its president.[3] By virtue of his office, a president of a corporation may collect subscriptions to the capital stock.[4] In a Missouri case a corporation, a transfer company, was held liable upon promissory notes, given for the purchase of mules for its use, and signed in its name by its president.[5]

Holbrook *v.* Fauquier, etc., Turnpike Company, 3 Cranch C. Ct., 425; Wait *v.* Nashua Armory Assn., (N. H.) 23 Atl. Rep. 77; s. c., 34 Cent. L. J. 119; 14 Law Rep. Anno. 356; Mt. Sterling, etc., Turnpike Road Co. *v.* Looney, 1 Metc. (Ky.) 550; s. c., 71 Am. Dec. 491; Bacon *v.* Mississippi Insurance Co., 31 Miss. 116; Walworth County Bank *v.* Farmers' Loan & Trust Co., 14 Wis. 325; Titus *v.* Cairo, etc., R. R. Co., 37 N. J. Law, 98; Dawes *v.* North River Insurance Co., 7 Cowen, 462; Mahone *v.* Manchester, etc., R. R. Corp., 111 Mass. 72; s. c., 15 Am. Rep. 9; Marine Bank *v.* Clements, 3 Bosw. 600; Lyndon Mil. Co. *v.* Lyndon Literary & Biblical Inst., 63 Vt. 581; s. c., 22 Atl. Rep. 575; 25 Am. St. Rep. 783; Westerfield *v.* Radde, 7 Daly, 326; Western R. R. Co. *v.* Bayne, 11 Hun, 166; Hodge *v.* First National Bank, 22 Gratt. 51; Brooklyn Gravel Road Co. *v.* Slaughter, 33 Ind. 185; First National Bank *v.* Kimberlands, 16 W. Va. 555. That the power of a president in making contracts on behalf of a corporation is restricted to the authority being conferred on him by the corporation, see Bacon *v.* Mississippi Ins. Co., 31 Miss. 116.

[1] Mount Sterling & Jeffersonville Turnpike Road Co. *v.* Looney, (1858) 1 Metc. (Ky.) 550.

[2] Life & Fire Insurance Co. *v.* Mechanics' Fire Ins. Co., 7 Wend. 31.

[3] Market Co. *v.* Jackson, 102 Pa. St. 269.

[4] Wright's Appeal, (1882) 99 Pa. St. 425; citing Angell & Ames on Corp. §§ 220–297; Martin *v.* Great Falls Manufacturing Co., 9 N. H. 51.

[5] Oakes *v.* Cattaraugus Water Co., (1894) 143 N. Y. 430; s. c., 38 N. E. Rep. 461; 62 N. Y. St. Repr. 445; Hastings *v.* Brooklyn Life Ins. Co., 138 N. Y. 473; s. c., 34 N. E. Rep. 289; Conover *v.* Insurance Co., 1 N. Y. 290; Booth *v.* F. & M. N. Bank, 50 N. Y. 396; Leslie *v.* Lorillard, 110 N. Y. 519; s. c., 18 N. E. Rep. 363; Holmes, Booth & Haydens *v.* Willard, 125 N. Y. 75; s. c., 25 N. E. Rep. 1083; Patterson *v.* Robinson, 116 N. Y. 193; s. c., 22 N. E. Rep. 372; Rathbun *v.* Snow, 123 N. Y. 343; s. c., 25 N. E. Rep. 379; New York P. & B. R. R. Co. *v.* Dixon, 114 N. Y. 80; s. c., 21 N. E. Rep. 110.

[1] Marine Bank *v.* Clements, 6 Bosw. 166.

[2] Sistare *v.* Best, 16 Hun, 611.

[3] Silva *v.* Metropolitan Drug Co., 42 N. Y. Super. Ct. 307. In Brouwer *v.* Harbeck, 1 Duer, 114, an insurance company was authorized by its charter to receive premium notes in advance and negotiate them to raise money for the payment of losses or otherwise in the course of its business. The president of the corporation was empowered by its by-laws to sign policies and transact the ordinary business of the corporation. It was held that the borrowing of money and hypothecation of these premium notes for the purpose of paying losses, and afterwards having these notes discounted by the lender in payment of the loss, was in the transaction of the ordinary business of the corporation, and did not require a previous resolution of the board of directors.

[4] East New York, etc., R. R. Co. *v.* Lighthall, 5 Abb. Pr. (N. S.) 458; s. c., 36 How. Pr. 481; 6 Robt. 407. In Georgia Company *v.* Castleberry, (1871) 43 Ga. 187, where the corporation was of the same name with a partnership doing business by the same agent before the date of the charter, it was held that the assumption of a debt due by the old partnership with no new consideration was outside of the scope of the charter, and, therefore, outside of the scope of the president's duties, as they were derived from the nature of his office, and even a written contract promising to pay this debt would be of doubtful validity unless there was special authority from the company.

[5] Sparks *v.* Dispatch Transfer Co., (1891) 104 Mo. 531; s. c., 15 S. W. Rep. 417; 24 Am. St. Rep. 351; 12 Law Rep. Anno. 714; 33 Am. & Eng. Corp. Cas. 373. "The power of [the president] to bind [the corporation]," said the Supreme Court of that state, "is governed by the law of agency. The principle underlying is the same, whether the principal be a corporation or an individual. It is now well settled that when, in the usual course of the business of a corporation, an officer

§ 143. Rule as to evidence in such cases.— In the Missouri case just referred to, some of the promissory notes, with which it was sought to charge the corporation, were signed by its president as an individual. The Supreme Court of Missouri held that where such negotiable notes are signed by the president of a corporation in his own name, and nothing appears in the instrument to indicate he was acting as agent of the corporation, extrinsic evidence was inadmissible to show such agency.[1] In a late New

has been allowed to manage its affairs, his authority to represent the corporation may be implied from the manner in which he has been permitted by the directors to transact its business. This is only the application of the principle that usual employment is evidence of the powers of an agent, and the principal is held responsible for the acts of his agent within the apparent authority conferred on the agent. First National Bank *v.* North Missouri, etc., Co., 86 Mo. 125; Washington Mut. Fire Ins. Co. *v.* Seminary, 52 Mo. 480; Kiley *v.* Forsee, 57 Mo. 390; Martin *v.* Webb, 110 U. S. 7; Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192. The president of a business corporation is its chief executive officer. He may, without any special authority from the board of directors, perform all acts of an ordinary nature which, by usage or necessity, are incident to his office, and may bind the corporation by contracts in matters arising in the usual course of business. Boone on Corp. § 144; Stokes *v.* Pottery Co., 46 N. J. Law, 237." Applying the principles to the case at bar, it was said: "[The president of the company] purchased every mule that [the corporation] owned from its organization until after the execution of the notes sued on in this case. He had repeatedly signed notes in the name of the corporation, and the corporation had honored his orders and paid his notes so drawn. Plaintiffs had thirteen different transactions with him as the president and purchasing agent of the [corporation] prior to the giving of the notes herein, and his acts had always been ratified. The [corporation] was engaged in a transfer business, in which the motive power was mules, and it was its written charter privilege to buy mules and execute its notes therefor. [The president] had purchased mules for the [corporation] of the plaintiffs, and on this occasion he informed them he was purchasing the mules for which these two notes were given for the [corporation]. His transaction, under the evidence, was within both his actual and apparent authority to bind the [corporation]."

[1] Sparks *v.* Dispatch Transfer Co., (1891) 104 Mo. 551; s. c., 15 S. W. Rep. 417. The court reviewed a number of cases from other states sustaining this view, and then, as it was claimed that this doctrine had been repudiated by the courts of Missouri in certain cases, these latter were reviewed and distinguished as follows: "The leading case relied upon by respondents is Washington, etc., Ins. Co. *v.* Seminary, 52 Mo. 480. The note which was the basis of the action in that case was as follows:

'$750.

'For value received in policy number 2,969, dated the fourteenth day of March, 1866, issued by the Washington Mutual Fire Insurance Company of St. Louis, I promise to pay said company (or their secretary for the time being) the sum of $750, in such portions and at such time or times as the directors of said company may, agreeably to their acts of incorporation, require.

'[Signed] DANIEL McCARTHY,

'*President.*

'Per THOMAS BURKE.'

"This court held that it was competent to explain the ambiguity on the face of the note itself. Speaking for the court, Judge SHERWOOD said in that case: 'In the present case, the note sued on is signed 'Daniel McCarthy, President.' But president of what? Just here, under the rules laid down in the above cases, parol evidence steps in and affords a ready and satisfactory explanation. The word 'president,' attached to the name of Daniel McCarthy, is an earmark of the official capacity in which the note was signed — not evidence, it is true, that the note was signed in that capacity, but a sufficient basis for the introduction of testimony tending to establish that fact.' The court resumed: 'Moreover, in that case the note on its face referred to policy number 2,969, which insured the seminary building and church building belonging to St. Mary's Seminary. It will be observed, *first*, that the above note is *not negotiable*, and, *secondly*, that the ambiguity appears on its face, growing out of the word 'president,' affixed to McCarthy's name. In the case at bar the notes are, by their terms, *negotiable*, and contain nothing but Jackson's name as maker; so that this case is not authority, because the facts are entirely different.' It is true, however, that, in this case, Judge SHERWOOD quotes from the decision in Mechanics' Bank of Alexandria *v.* Bank, 5 Wheaton, 327, in which the Supreme Court of the United States says: 'It is by no means true, as was contended in argument, that the acts of agents derive their validity from professing on the face of them to have been done in the exercise of their agency.' If this were all, it must be conceded that respondents are justified in claiming that this decision is broad enough to permit parol evidence in any case to explain who was the principal, notwithstanding there is no intimation on the face of the paper that any one but the agent is a party to it. But the Supreme Court of the United States did not put their decision on that ground; but, on the contrary, Justice JOHNSON, who delivered the opinion, expressly says: 'But the fact that this appeared *on its face* to be a private check is by no means to be conceded; on the contrary, the *appearance* of the *corporate* name of the institution *on the face of the paper* at once leads to the belief that it is a *corporate*, and not an individual, transaction; to which must be added that the cashier is the drawer, and the teller the payee, and the form of ordinary *checks* deviated from by the substitution of 'to order' for 'to bearer.' The *evidence*, therefore, on the *face* of the bill predominates in favor of its being a bank transaction. But it is *enough* for the purposes of a defendant to establish that there *existed* on the face of the paper circumstances from which it might reasonably be inferred that it was either one or the other, and in such a case to resort to extrinsic evi-

York case there was a contention that although the corporation might be legally liable for the debt, still the notes in the first instance having been made and discounted for the accommodation of Woodruff (its president), the debt was not contracted in the business for which the corporation was created, and the mort-

gage could not, therefore, be enforced for its payment. The court held that the refusal to find that these notes were made and discounted for the accommodation of the president individually, and that the debt was not contracted in the business for which the company was created, was justified by the evidence.[1]

dence to remove the doubt.' So that it seems clear that the Supreme Court placed its decision upon the fact that, upon the face of the paper the ambiguity appeared. That court would never have held that there was any ambiguity on the face of the notes sued on [there]. Falk *v.* Moebs, 127 U. S. 597. In 31 Mo. 193 (Smith *v.* Alexander), the action was on the following note:

'$500. St. Louis, Mo., *July* 22, 1855.

'Ninety days after date I promise to pay to the order of Messrs. Smith & Co., $500, for value received, negotiable and payable without defalcation or discount.

'[Signed] J. H. ALEXANDER,

'*Treasurer, Ohio & Miss. R. R. Co.*'

"In that case Alexander, having been sued on this note, was allowed to show that he was treasurer of the Ohio railroad, and that he gave the note simply as agent of said company, Judge Ewing saying: 'A mere addition to the name of the party signing the contract cannot be regarded as a certain *indicium* that it was made on behalf of another. When, however, it is *doubtful from the face* of the contract whether it was intended to operate as a personal engagement of the party signing it, or to impose an obligation on some third person as principal, evidence is admissible to show the character of the transaction.' So we see that Judge Ewing placed his ruling on the *doubt* appearing on the face of the note whether it was the obligation of Alexander or the railroad company."

[1] Martin *v.* Niagara Falls Paper Manufg. Co., (1890) 122 N. Y. 165; s. c., 25 N. E. Rep. 303, affirming 44 Hun, 130. The court said: "The burden of proving that the notes were not given in the business of the corporation rested upon the defendant. [The plaintiff], the president of the bank, testified that he had no knowledge of the proceeds being used for Woodruff's benefit, and the facts of the case do not bring it within the rule which puts upon a holder of a promissory note or other corporate obligation the burden of proving by direct evidence that it was issued pursuant to a vote of the trustees, or for a corporate debt, or that the corporation received the consideration, in order to establish a corporate liability. The cases where this rule has been held are those of special agency. The general rule, of course, is that the agent's authority in all cases must be shown to charge the principal with an act performed by the agent, but in many instances this fact may be established by presumptive evidence. And this is so where the corporation, whose obligation is in question, is engaged in a business, the nature of which and the duties in relation to which devolved upon its officers, require or justify the giving of negotiable instruments without being authorized thereto by a special vote to that effect. If the scope of the agent's authority be proven and it appears that acts like the one in question would, under ordinary circumstances, be within the authority, a presumption arises that the necessary circumstances did exist and that the act in question was authorized. Morawetz on Corp. § 616; Lincoln *v.* Iron Co., 103 U. S. 412;

§ 144. Power of president as to transfer of assets.—There is no power in a president and general manager of a corporation, as such, to borrow money for the corporation and to assign the assets of the corporation as a security for the loan,[1] but in accordance with the uniform practice of a corporation, its president may transfer the title to a promissory note by an indorsement signed by him as president.[2] The presumption that the president of a corporation had power to execute it, is carried with an assignment of a claim owned by the corporation exe-

Patterson *v.* Robinson, 116 N. Y. 193; F. & M. Bank *v.* B. & D. Bank, 16 N. Y. 125; N. R. Bank *v.* Aymar, 3 Hill, 262. It was said in Farmers' Bank *v.* Butchers & Drovers' Bank that the sound rule is that 'when a party dealing with an agent has ascertained that the act of the agent corresponds in every particular, in regard to which such party has or is presumed to have any knowledge, with the terms of the power, he may take the representations of the agent as to any extrinsic fact which rests particularly within the knowledge of the agent, and which cannot be ascertained by a comparison of the power with the act done.' The court then said: 'The case is analogous to the giving of a firm note by one partner for his own benefit. When such a note is given in a transaction unconnected with the partnership business and known to be so by the person taking it, the other partners are not bound without their consent, but, *prima facie*, the firm note binds all the partners, and the burden of proving a want of authority lies upon the firm. Doty *v.* Bates, 11 Johns. 544; Gansevoort *v.* Williams, 14 Wend. 133–138.' The nature of the business of the paper company justified the giving of negotiable paper, and the making of such instruments was an incident to the business it carried on. It was a frequent occurrence in the management of its affairs. The by-laws which required the secretary to sign all obligations of the company had never had any force and were unknown to the bank. What the bank did know was that Woodruff [who made the notes] was president, general manager and financial agent of the company. He was such by the general acquiescence of the stockholders. He and * * * daughter owned the stock of the company. For twenty-five years there had been no meeting of the stockholders for the election of officers and very few meetings of the trustees, and Woodruff had managed the business as if it was his own. He bought its supplies, sold its products and paid its debts. No other person was shown to have had a voice in the management of its affairs. Under such circumstances, the giving of a promissory note in the name of the company for money borrowed was not only within the apparent scope of Woodruff's authority, but the long period during which, without interference, he was permitted to manage the company's affairs, justified the inference that it was within his actual authority. Martin *v.* Webb, 110 U. S. 7. The bank was, therefore, justified in relying upon the presumption that the notes, being made in the name of the company, were given in its business and for its benefit."

[1] Hyde *v.* Larkin, (1889) 35 Mo. App. 365.

[2] Scott *v.* Johnson, 5 Bosw. 213; Merchants' Bank *v.* McColl, 6 Bosw. 473.

cuted by its president under its corporate seal, reciting an authority from the board of directors to execute it.[1] When the transfer of a note belonging to a corporation has been authorized by a resolution of its board of directors, its president has power to indorse it over.[2] As against the parties to a note, the presumption is that the president of a corporation indorsing it over was authorized to do so.[3] The president of a corporation may be authorized to indorse its notes by the directors, who with the president by the charter have full power to conduct its affairs.[4]

§ 145. When a president's act is binding.— A manufacturing corporation of Connecticut, for the purpose of manufacturing a certain class of goods and to prepare for the same, arranged with a New York firm of commission merchants that the latter advance to the corporation, as called for, money to the amount of $100,000, to be secured by a mortgage upon its real property and its personal property to this extent, that the goods manufactured of this kind would be shipped to the firm to be sold on commission and the avails of the sales applied to the settlement of the bond and mortgage. Advances were made to an amount slightly exceeding the amount of the limit; goods were shipped and sold on commission, etc. The president of the corporation, its principal business and financial manager, requested this firm to make advancements to the corporation in addition to those contemplated and secured by mortgages, and verbally agreed that these should be secured by the mortgages, by the products of the mill previously and subsequently consigned to them, and certain shares of stock which the corporation held in pledge. There was advanced upon the agreement a large sum of money in addition to that already advanced. There was no vote either of stockholders or directors authorizing such borrowing or agreement. In an action for foreclosure of the mortgage the Supreme Court of Connecticut held that the firm was entitled to a decree of foreclosure and sustained the right of the firm to apply, as it had done, the proceeds of the sale of products of the corporation to the later

[1] Corbit *v.* Nicoll, 12 N. Y. Civ. Pro. 235.

[2] Clark *v.* Titcomb, 42 Barb. 122

[3] Elwell *v.* Dodge, 33 Barb. 336.

[4] Merrick *v.* Trustees of the Bank of the Metropolis, 8 Gill. (Md.) 64. As to president's power to draw, accept, and indorse bills of exchange, see Jones *v.* Hawkins, 17 Ind. 550; Allison *v.* Hubbell, 17 Ind. 559.

advances made under this arrangement with the president instead of upon the bond which the mortgage was executed to secure.[1]

§ 146. Illustrations of the power of a president.— The contracts binding a corporation which the president thereof has authority to make, by virtue merely of his official position, are confined to those relating to matters arising in the ordinary course

[1] Lewis *v.* Hartford Silk Manufacturing Co., (1887) 56 Conn. 25. In its opinion as to the binding effect upon the corporation of the transactions of its president the court said: "No vote [of stockholders or directors] was necessary to make the acts of [the president] binding upon the corporation. Having made him its principal and general financial manager and agent, with no limitation upon his power, and having notified all persons concerned of such appointment, the company is bound by his act of borrowing for its benefit and of pledging [the products of the mill] or any other personal property for repayment. He was clothed with power to borrow money for its necessary and proper uses from any person who would lend; to sell [their products] and repay; or consign [them] with leave to retain the proceeds; or use any other property for that purpose. And as in these matters, in legal contemplation, he was the corporation, he could bind it as effectually as it could bind itself by corporate vote when taking up money by an agreement that payment should be secured by the previous mortgage, provided (in the interest of other creditors) the aggregate should not exceed the extreme limit of one hundred thousand dollars. Of course a corporate vote was necessary to a valid mortgage by its financial agent of the real estate of the [corporation] to the plaintiffs. But all money or other personal property or rights therein coming into its possession because of the mortgage security thus given were at the disposal of its general unlimited financial agent, equally with any other personal property belonging to it. A corporate vote is not made necessary to the valid disposition of this right in personal property because of the mention of it in a sealed instrument. Therefore, if we should concede that, as against the plaintiffs, the agreement between them and the [corporation] constituted a valuable right in the possession of the latter, nevertheless [its president] had absolute power of disposal of this right for its benefit. He could exchange, sell, pledge or annul it by his individual action at his discretion. Presumably the agreement by the mortgagor to deliver, and by the mortgagee to receive [the products of the mill], in payment was for the benefit of the latter, and although it has a place in the condition of the mortgage, they were under no obligation to see in it any limitation upon the power of the mortgagor's general financial agent thereafter to borrow, if they should be willing to lend, other and additional sums for its benefit, and make payment therefor in money, [products of the mill], or any other personal property. The purpose of the mortgagee was to give satisfactory security for the loan of one hundred thousand dollars, not at all to bar itself from borrowing other money if a willing lender could be found. As it is the company's duty always to pay its debts, the application of any of its personal property or rights in stock at any time to that use by its accredited

of the business of the corporation.[1] And a corporation, for instance, engaged in the business of conveying water through ditches for sale to miners, would not be bound by a contract of its president for a purchase of additional ditch property with a view of extending the operations of the corporation, as this would not be a matter within the ordinary course of the business of the corporation.[2] The managing board of a private corporation having conferred, by a resolution of such board, upon the president of the corporation the full power of the corporation in reference to municipal street work, the president of the corporation may contract with a city on behalf of the corporation to improve a street.[3] If made the duty of a president of a corporation to generally supervise its entire business, and it be provided that all of the property of the corporation shall be under his control, by a by-law of the corporation, and it appears that for many years its president has acted as its attorney, and looked after its litigation, such facts will be evidence of his authority to employ counsel to look after the interests of the corporation in any pending litigation.[4] A corporation may be bound by its president's entering satisfaction of a judgment in its favor, after an assignment to a third person, though the satisfaction piece be not under the seal of the corporation.[5] The president of a manufacturing corporation, who is also its superintendent, clothed with general authority to contract by parol, without the seal of the corporation, for

financial agent without limitation is binding upon it. And whatever valuable property right as against [the pledgor], the [corporation] had in the use and application of his shares, [stock of another corporation pledged to it], that right was at the disposal of [its president] for the benefit of the company by sale or pledge, [the pledgor's] rights of course not to be affected by any act of [the president] not authorized or ratified by himself."

[1] Blen *v.* Bear River & Auburn Water & Mining Company, (1862) 20 Cal. 602.

[2] Ibid. In Shaver *v.* Bear River & Auburn Water & Mining Co., (1858) 10 Cal. 396, the court held that the president of this corporation had authority to bind the corporation for the purchase of a house to be used as an office for the corporation and as a boarding house for the laborers it employed under a resolution of the corporation vesting him with discretionary power as to "all matters pertaining to the prosecution of the projects of the company," and if his authority were doubtful, the acts of the corporation amounted to a ratification of the contract.

[3] Oakland Paving Company *v.* Rier, (1877) 52 Cal. 270.

[4] Wetherbee *v.* Fitch, (1886) 117 Ill. 67; s. c., 7 N. E. Rep. 513.

[5] Booth *v.* Farmers & Mechanics' Bank, 50 N. Y. 396.

making and delivering its manufactured goods, has like authority, unless the power is withdrawn, to authorize the termination and release of such a contract.[1] A railway corporation will be bound by a contract made by its president, in its behalf, and within the scope of its chartered powers, to pay fixed sums of money to the proprietors of a railway bridge for the use of the same, where it is made known to the directors and stockholders and not disapproved by them within a reasonable time.[2] No proof of the authority of the president of a corporation will be required to establish an assignment made by the corporation, through its president, of a special tax bill.[3] The lease of an office is within the usual powers of the president of a corporation, and his declarations, when making such a contract, are evidence of the intended purpose for which it may be leased.[4] A corporation will be bound by the act of its president, after its organization, in receiving a conditional subscription.[5] A corporation will be bound by its president's receiving a promissory note, on settlement against the maker, though made payable to the president or his order by his individual name, if he has been in the habit of acting as its business agent, with the knowledge of the corporation and without objection on its part.[6] It is within the scope of a president's authority, as president, to undertake to bring before the board of directors of a corporation, at a time specified, a demand against the corporation for money borrowed by an agent of the corporation, and the corporation will be bound to consider the demand at the time specified.[7]

[1] Indianapolis Rolling Mills *v.* St. Louis, Fort Scott & Wichita Railroad, (1887) 120 U. S. 256; s. c., 7 Sup. Ct. Rep. 542.

[2] Pittsburgh, Cincinnati & St. Louis Ry. Co. *v.* Keokuk & Hamilton Bridge Co., (1889) 131 U. S. 371; s. c., 9 Sup. Ct. Rep. 770.

[3] Bambrick *v.* Campbell, (1889) 37 Mo. App. 460.

[4] Baltimore & Philadelphia Steamboat Co. *v.* McCutcheon, 13 Pa. St. 13.

[5] Pittsburgh & Connellsville R. R. Co. *v.* Stewart, 41 Pa. St. 54.

[6] Dougherty *v.* Hunter, 54 Pa. St. 380. As to power of president to appoint attorneys for looking after litigation of corporation, see Reno Water Company *v.* Leete, 17 Nev. 203; s. c., 30 Pac. Rep. 702; American Insurance Co. *v.* Oakley, 9 Paige, 496; s. c., 38 Am. Dec. 561; Wetherbee *v.* Fitch, 117 Ill. 67; s. c., 7 N. E. Rep. 513. As to president's indorsing commercial paper for transfer, see Irwin *v.* Bailey, 8 Biss. 523; Howland *v.* Myer, 3 N. Y. 290; Caryl *v.* McElrath, 3 Sandf. 176; Palmer *v.* Nassau Bank, 78 Ill. 380. As to power of the president of a bank to contract for the bank, see Case *v.* Hawkins, 53 Miss. 702.

[7] Union Gold Mining Co. *v.* Rocky Mountain Bank, 1 Colo. 531. As to making sales of commodities of cor-

§ 147. **Illustrations of his lack of power.**—The president of a corporation has no legal power or authority to deplete the coffers of the corporation by instructing the treasurer to refuse to accept subscription money when tendered.[1] An authority given by a resolution of the board of directors to a president of a corporation "to make all contracts and draw on the treasurer for all disbursements (countersigned by the secretary) under the direction of the board," does not confer upon the president power to make contracts for, or otherwise bind, the corporation without the "direction of the board" of directors, and his acceptance of a bill drawn upon him as president, without the direction of the board of directors, would not bind the corporation.[2] There is no power in the president of a corporation, by virtue of his office, to purchase or sell real property for the corporation at his discretion. Such power can be conferred only by the board of trustees.[3] A resolution being upon the minutes of a corporation forbidding its president purchasing such goods, the president cannot bind it for goods purchased.[4] Where a contract has been entered into by authority of its board of directors, the president of a corporation in the usual course of the business of the corporation, see Horton Ice Cream Company *v.* Merritt, 63 Hun, 628; s. c., 17 N. Y. Supp. 718; 43 N. Y. St. Repr. 416. As to the effect of a president's acknowledgment of a debt, taking it out of the Statute of Limitations, see Morgan *v.* Merchants' Bank, 13 Lea, (Tenn.) 234.

[1] Potts *v.* Wallace, (1892) 146 U. S. 689, 705; s. c., 13 Sup. Ct. Rep. 196, in which the question whether or not a subscriber to the stock had been released from his obligation to pay it for the benefit of the creditors by the action of the president or otherwise. The court followed Bank of the United States *v.* Dunn, 6 Pet. 51, where it was held that an agreement by the president and cashier that the indorser on a note shall not be liable on his indorsement does not bind the bank; that it is not the duty of the cashier and president to make such contracts, nor have they the power to bind the bank except in the discharge of their ordinary duties. The court, in Potts *v.* Wallace, *supra*, further said: "It is true that if the acts of the president are ratified by the corporation, or the corporation permits a general course of conduct or accepts the benefit of his act, they will be bound by it. But the general rule is that the president cannot act or contract for the corporation except in the course of his usual duties. And the rule is still stronger against the power of the president to bind the corporation by giving up its securities or releasing claims in its favor."

[2] Lazarus, Use of, *v.* Shearer, (1841) 2 Ala. 718.

[3] Bliss *v.* Kaweah Canal & Irrigation Co., (1884) 65 Cal. 502.

[4] Westerfield *v.* Radde, 7 Daly, 326. In Smith *v.* Smith, (1875) 117 Mass. 72, it appeared that a corporation held a mortgage of land assigned to it by the mortgagee as collateral security for the payment of a note which was also secured by a mortgage of other land owned by him. By vote afterwards the corporation authorized its president and secretary to cancel the principal mortgage, but, by mistake, the president discharged both mortgages upon the record. There was a provision in the charter of the corporation that the president should keep the corporate seal, but the only provision in its charter or its by-laws relating to the execution of contracts in its behalf was, that the corporation should be bound by all instruments which it should lawfully make, when executed in its name and pursuant to its rules, signed and delivered by the president, secretary, treasurer or other officers or persons it should appoint, and sealed by its common seal. The Supreme Court of Judicature held that the discharge of the collateral mortgage was without authority from the corporation and void.

poration, without the assent of the directors, has no power to modify it.[1] The president of a corporation, as such, has no power to bind the corporation by any act outside his official duty.[2] The superintendent of a mining corporation has no authority, *virtute officii* merely, to borrow money on the credit of the corporation.[3] And the president of such a corporation has no power, as presi-

[1] Western Railroad Co. *v.* Bayne, 11 Hun, 166; s. c., 75 N. Y. 1. For classes of contracts or agreements in which a president cannot bind the corporation, see Spyker *v.* Spence, 8 Ala. 333; First National Bank *v.* Reed, 36 Mich. 263; St. Nicholas Insurance Co. *v.* Howe, 7 Bosw. 450; First National Bank *v.* Bennett, 33 Mich. 520; Leavitt *v.* Connecticut Peat Co., 6 Blatchf. 139; Leggett *v.* New Jersey Manuf. Co., 1 N. J. Eq. 541; s. c., 23 Am. Dec. 728; Fitzhugh *v.* Franco-Texas Land Co., 81 Tex. 306; s. c., 16 S. W. Rep. 1078; McKeag *v.* Collins, 87 Mo. 164; Olney *v.* Chadsey, 7 R. I. 224; Hodge *v.* First National Bank, 22 Gratt. 51; Brouwer *v.* Appleby, 1 Sandf. 158; Hone *v.* Allen, 1 Sandf. 171, note; Thompson *v.* McKee, 5 Dak. 172; s. c., 37 N. W. Rep. 367; Ellsworth Woolen Manufg. Co. *v.* Faunce, 79 Me. 440; s. c., 10 Atl. Rep. 250; Ashuelot Manufg. Co. *v.* Marsh, 1 Cush. 507; Globe Works *v.* Wright, 106 Mass. 207; White *v.* Westport Cotton Manufg. Co., 1 Pick. 215; s. c., 11 Am. Dec. 168; E. Carver Company *v.* Manufacturers' Ins. Co., 6 Gray, 214; Markey *v.* Mutual Benefit Ins. Co., 103 Mass. 78; Merchants' National Bank *v.* Rawls, 7 Ga. 191; s. c., 50 Am. Dec. 394; Asher *v.* Sutton, 31 Kans. 286; Reynolds, etc., Constr. Co. *v.* Police Jury, 44 La. Ann. 863; s. c., 11 So. Rep. 236; Potts *v.* Wallace, 146 U. S. 689; s. c., 13 Sup. Ct. Rep. 196; Bank of United States *v.* Dunn, 6 Pet. 51; Weeks *v.* Silver Islet Consolidated Mining Co., 55 N. Y. Super. 1; s. c., 8 N. Y. St. Repr. 110; First National Bank *v.* Lucas, 21 Neb. 280; s. c., 31 N. W. Rep. 805; Foster *v.* Essex Bank, 17 Mass. 479; s. c., 9 Am. Dec. 168; Dowd *v.* Stephenson, 105 N. C. 467; s. c., 10 S. E. Rep. 1101.

[2] Perry *v.* Simpson Waterproof Manufacturing Co., 37 Conn. 531. In Stallcup *v.* National Bank of the Republic, (1888) 15 N. Y. St. Repr. 39, in the absence of proof of the authority of its president to accept drafts of a corporation upon the bank, and in the face of evidence that the obligee of the drafts knew that similar transactions of the president had failed to meet the sanction of the directors, the bank was held not to be liable.

[3] Union Gold Mining Co. *v.* Rocky Mt. Bank, 2 Colo. 565.

dent, to undertake, in the corporate name, for the repayment of such an unauthorized loan.[1] The Illinois Appellate Court sustained a decree dismissing a bill to compel a corporation to renew a lease of a building belonging to it, because of a lack of power or authority in the president of the association to bind it by an agreement to make or renew a lease of its estate.[2]

§ 148. What would show the authority of a president.— A corporation admitting, at the trial of a case, that the one making the contract which the corporation claimed to be unauthor-

[1] Ibid.

[2] Koch *v.* National Union Building Association, (1890) 35 Ill. App. 465; affirmed in 137 Ill. 497; s. c., 27 N. E. Rep. 530. The court said: "The president of a corporation has not, as matter of law, and merely by reason of his holding said office, power or authority to execute deeds, mortgages or leases of the real estate of the corporation. Hoyt *v.* Thompson, 19 N. Y. 207. The implied powers of the president of a corporation depend upon the nature of the company's business, and the measure of authority delegated to him by the board of directors. It seems that the president has no greater powers, by virtue of his office merely, than any other director of the company, except that he is the presiding officer at the meeting of the board. Morawetz on Corporations, § 537. There is no proof in the record as to what the business of [defendant corporation] is, but it is shown that its business, whatever it may be, is carried on under certain by-laws, section 9 of which by-laws relates to the duty of the president, and, among other things, provides that 'he shall execute all bonds, contracts, leases or other instruments required to be made or executed by authority of the board for and on behalf of the association, which shall also be signed by the secretary.' Here we find the authority of the president with reference to executing leases defined, and while it is true that it has been said by the Supreme Court of this state that an act done by the president will be presumed to be legally done and be binding on the body, that rule applies 'in the absence of legislative enactment or provision made in the by-laws.' Smith *v.* Smith, 62 Ill. 493. The business affairs of corporations are controlled exclusively by their boards of directors, and such board may undoubtedly invest the president with authority to bind the corporation by deed or lease, either by express resolution or by an acquiescence in his assumption of authority in that respect, which would justify persons who dealt with him in the inference that he had such authority in fact. So if the act is one incident to the execution of the trust reposed in him, such as custom or necessity has imposed upon this office, he may perform it without express authority. Mitchell *v.* Deeds, 49 Ill. 416. As we understand Union Mutual Life Ins. Co. *v.* White, 106 Ill. 67, it simply holds the corporation bound by acts which, from the course of its business, were within apparent power of the president and general agent when those officers were acting for the corporation in a state where the corporation was doing business by comity, the home or residence of the corporation being in another state."

ized was its president and superintendent as well as general manager, the Supreme Court of California held to be sufficient evidence of his authority to make the contract, and it was not necessary, upon the party seeking to enforce it, to show any vote or other corporate act constituting him the agent of the corporation.[1]

[1] Crowley *v.* Genesee Mining Company, (1880) 55 Cal. 273. It was said in the opinion: "The common-law rule that a corporation has no capacity to act or to make a contract, except under its common seal, has long since been exploded in this country. Even in England it has been found to be impracticable, so that the classes of cases which constitute exceptions to the rule have become so numerous that the exceptions have almost abrogated the rule. In the United States nothing more is requisite than to show the authority of the agent to contract. That authority may be conferred by the corporation at a regular meeting of the directors, or by their separate assent, or by any other mode of their doing such acts. If this were not so," says Mr. Chief Justice REDFIELD, "it would lead to very great injustice, for it is notorious that the transaction of the ordinary business of railways, banks, and similar corporations in this country, is without any formal meetings or votes of the board. Hence, there follows a necessity of giving effect to the acts of such corporations, according to the mode in which they choose to allow them to be transacted. If this were not done. it would become impossible to dispose of such contracts with any hope of reaching the truth and justice of the right and duties of the several parties involved. * * * This is merely holding corporations to such rules of action as they see fit to adopt for their own guidance and the transaction of their business." Bank of Middlebury *v.* Rutland R. R. Co., 30 Vt. 159. * * * It would not be in accordance with justice or the interests of society to allow corporations to deny the authority of such agents, or to repudiate contracts made by them for work and labor from which they derive benefit. So, in Goodwin *v.* Union Screw Company, 34 N. H. 378, where it appeared that the business of manfacturing screws was conducted under the general management of one of its directors, who made verbal contract with the plaintiff to work in the shop, at manufacturing screws for the defendant, the Supreme Court of New Hampshire held that where one has the actual charge and management of the general business of a corporation, with the knowledge of the members or the directors, this is sufficient evidence of authority, and the company will be bound by his contracts made in their behalf, within the apparent scope of the business intrusted to him. And in Wilson Sewing Machine Company *v.* Boyington, 73 Ill. 534, where it appeared that an architect had drawn plans for a building for a corporation under a verbal contract made with one who was acting as president, executive manager and principal stockholder of the company, the Supreme Court of Illinois held that the contract was binding upon the corporation. "A corporation," says the court, "which suffers appearances to exist, and its officers and agents to so act as to give one employed by such officers and agents reason to believe that he is employed by the company, becomes liable to such person as his employee, to pay for the services rendered."

§ 149. Question of authority for the jury.— In a case before the New York Court of Appeals, which was an action upon certain promissory notes made payable to a domestic corporation and indorsed by its president, it appeared that the corporation had its main office in the city of New York, and while a portion of its business was transacted and most of its purchases and sales were made in other states and countries, its principal business operations were carried on in that city, and the annual meeting of its directors was there held. The person who indorsed these notes was president and treasurer, the general manager of all the corporation's business affairs in that city, and the only officer in attendance at its office there; he paid the current accounts of the company and indorsed checks made payable to its order. The discount of business paper and the use of its money for its purposes, and the account of the same on its cash books were daily and permitted transactions. The corporation had no cash capital, and its working capital was borrowed on the credit of the company, and this borrowing was done principally by the president, and mainly by the use of paper indorsed by him in the name of the corporation. The evidence on the trial tended to show that this was with the knowledge and acquiescence of the directors. The Court of Appeals held that it was error in the lower court to dismiss the complaint; that the evidence required the submission of the question of the authority of the president of the corporation to bind it by indorsements to the jury.[1]

§ 150. Power of a president as to execution of notes.— The making of promissory notes of a corporation by its president to one who, at his instance and request, may advance money to pay indebtedness of the corporation to save it from a law suit, is within the scope of the business intrusted to him as superintendent and general agent of the corporation.[2]

[1] Fifth National Bank of Providence, R. I., *v.* Navassa Phosphate Company, (1890) 119 N. Y. 256; s. c., 23 N. E. Rep. 737.

[2] Seeley *v.* San José Independent Mill & Lumber Co., (1881) 59 Cal. 22. The court distinguished Hall *v.* Auburn Turnpike Co., 27 Cal. 255; Davis *v.* Rock Creek, L. F. & M. Co., 55 Cal. 359; San Diego *v.* S. D. & L. A. R. R. Co., 44 Cal. 106; Wilbur *v.* Lynde, 49 Cal. 290. In Farmers & Mechanics' Bank of Savings *v.* Colby, (1883) 64 Cal. 352, it was held that a note signed by one as president of a corporation and another as secretary *pro tem.*, they, at the time of its execution, discharging the duties of those respective offices, was the note of the corporation, and imposed no personal liability upon them as individuals. In National Spraker Bank *v.* Treadwell Co., (1894) 80 Hun, 363, where a promissory note of a corporation was executed by its president, but not signed by its treasurer in accordance with the by-laws of the corporation, the Supreme Court of New York in General Term held that the fact constituted no defense to an action on the note, if the paper was not diverted from its original purpose and went into the hands of a *bona fide* holder and the corporation received the benefit of the proceeds.

§ 151. In what cases the authority of a president may not be questioned.— The knowledge of all the members of a board of directors of a corporation, except one, who was absent from the county, the concurrence at the time of those who remained in the county, or their long-continued acquiescence afterward, has been held by the Supreme Court of Judicature of Massachusetts to have made valid, as the act of the corporation, the execution of a mortgage of its personal property, without special authority therefor, by its president, who was general manager of its business.[1] In case the president of a corporation, who is its managing officer and makes its contracts, enters into a fraudulent contract on its behalf, the corporation cannot escape liability on the ground that the president conducted the transaction without its knowledge or concurrence.[2] The by-laws of a corporation cannot be set up by the corporation as counteracting the authority conferred upon its president by permitting him to hold himself out to the public as its general manager and director of its business.[3] A corporation accepting the benefit of work done or materials furnished, upon the order of its president, will be estopped to deny the power of the president to make the contract.[4] The authority of a president of a corporation to subscribe for stock in another may be presumed upon the facts that the stock was received by an agent of the corporation he represented and retained by it, and that the stock on several occasions may have been voted by an officer or member of such corporation.[5]

[1] Sherman *v.* Fitch, (1867) 98 Mass. 59.

[2] Grand Rapids Safety Deposit Co. *v.* Cincinnati Safe & Lock Co., 45 Fed. Rep. 671.

[3] Marine Bank of Buffalo *v.* Butler Colliery Co., 52 Hun, 612; 23 N. Y. St. Repr. 318; s. c., 5 N. Y. Supp. 291; affirmed in 125 N. Y. 695; Bank of Attica *v.* Pottier & Stymus Mfg. Co., 49 Hun, 606; s. c., 1 N. Y. Supp. 483; 17 N. Y. St. Repr. 327. When a corporation is estopped to deny the authority of its president, see Alexander *v.* Brown, (1877) 9 Hun, 641.

[4] Brown *v.* Wright, (1887) 25 Mo. App. 54.

[5] Elysville Manufacturing Co. *v.* Okisko Company, 1 Md. Ch. 392; affirmed in 5 Md. 152. In Grape Sugar Manufacturing Co. *v.* Small, (1874) 40 Md. 395, an action to recover for work done under a contract with the acting

§ 152. Giving a judgment note — New Jersey. — The president of a corporation has no power, in virtue of his office, as president, to execute a bond and warrant of attorney for the entry of a judgment by confession against the corporation.[1] The president of this manufacturing corporation, the Court of Appeals held that it was not necessary to prove that the president was authorized by a direct vote or resolution of the corporation to make the contract. The work being necessary to enable the corporation to carry on the business for which it was incorporated, and accepted by it without objection, and without any intimation that its acting president was not authorized to make such contract, the jury on the trial might presume that the work was done by the authority of the corporation, or that it was subsequently accepted, and the contract ratified. In the same case it was further held that where, under the contract made with the acting president of the corporation after the certificate of incorporation was signed by the members of the proposed corporation, but before it was recorded, as required to constitute it a body politic under the General Incorporation Law, the work was done for the corporation and accepted after its incorporation was complete, the corporation would be estopped, both at law and in equity, from denying its liability on account of the same. See, as to the liability of corporations under similar circumstances, Baltimore City P. Ry. *v.* Sewell, 35 Md. 251; Edwards *v.* Grand Junction Ry. Co., 1 Mylne & Cr. 650; Wesley Church *v.* Moore, 10 Pa. St. 273; Attorney-General *v.* Corporation of Leicester, 9 Beav. 546; Hughes *v.* Antietam Manufacturing Co., 34 Md. 324; Fister *v.* La Rue, 15 Barb. 323; Low *v.* Connecticut & Passumpsic Railroad, 46 N. H. 284. As to estoppel of a corporation to deny the authority of its president to bind it where he has been held out to the public as possessing authority, see Ceeder *v.* H. M. Loud & Sons Lumber Co., 86 Mich. 541; s. c., 49 N. W. Rep. 575; 24 Am. St. Rep. 134; Sherman Center Town Co. *v.* Swigart, 43 Kans. 292; s. c., 23 Pac. Rep. 569; 19 Am. St. Rep. 137; Fitzgerald Constr. Co. *v.* Fitzgerald, 137 U. S. 98; s. c., 11 Sup. Ct. Rep. 36; Olcott *v.* Tioga, etc., R. R. Co., 40 Barb. 179; First Nat. Bank *v.* Kimberlands, 16 W. Va. 555; Fitzhugh *v.* Franco-Texas Land Co., 81 Tex. 306; s. c., 16 S. W. Rep. 1078; Washington Savings Bank *v.* Butchers', etc., Bank, 107 Mo. 133; s. c., 17 S. W. Rep. 644; 28 Am. St. Rep. 405; Dougherty *v.* Hunter, 54 Pa. St. 380; Libby *v.* Union National Bank, 99 Ill. 622; Neiffer *v.* Bank of Knoxville, 1 Head, (Tenn.) 162. Estoppel by reason of a presumption that corporation has ratified a contract of its president. West Salem Land Co. *v.* Montgomery Land Co., 89 Va. 192; s. c., 15 S. E. Rep. 524; Belleville Savings Bank *v.* Winslow, 35 Fed. Rep. 471; Bagaley *v.* Pittsburg Iron Co., 146 Pa. St. 478; s. c., 23 Atl. Rep. 837; Shaver *v.* Bear River, etc., Co., 10 Cal. 396.

[1] Stokes *v.* Jersey Pottery Co., (1884) 46 N. J. Law, 237. *Arguendo*, DEPUE, J., for the court said: "The powers of the president of a corporation, *virtute officii*, over its business and property are strictly the powers of an agent — powers delegated to him by the directors, who are the managers of the corporation, and the persons in whom, as its representatives, the control of its business and property is vested. If the corporation be organized for business purposes, the president is its chief executive officer. He may, without any special authority from the board of directors, perform all acts of an ordinary nature which, by usage or necessity, are incident to his office, and may bind the corporation by contracts arising in the usual course of its business. Boone on Corp., § 144. To this extent, the president, in virtue of his election as such, becomes the agent of the corporation. Beyond the powers which usage and custom and the necessities and convenience of business require in the executive officer of a corporation, he has no more control over the corporate property and funds than any other director. As illustrative of the restricted powers of a president of a corporation in the management of its business and control over its property, I will refer only to two cases in our own courts. In Titus *v.* Cairo & Fulton R. R. Co., this court held that a power of attorney executed by the president of a corporation, authorizing a sale of its bonds in the market, gave the agent no power to sell, and that the president could not execute such a power without the authority of the board of directors. In delivering the opinion of the court, Mr. Justice VAN SYCKEL said: 'In the absence of anything in the act of incorporation bestowing special power upon the president, he has, from his mere official station, no more control over the corporate property and funds than any other director. The affairs of corporate bodies are within the exclusive control of their boards of directors, from whom authority to dispose of their assets must be derived. The act of a president or other officer, unless it is shown to pertain to his official duty or to be within the scope of his employment, cannot be regarded as the act of the corporation, and is not binding upon it. The authority requisite to charge the company must, therefore, be derived from the board of directors.' 8 Vroom, 98–102. The other case is Leggett *v.* New Jersey Banking Co., Saxt. 541. In that case the charter of a bank provided that the affairs, property and concerns of the corporation should be managed by its directors; and the Court of Chancery held that, although a mortgage executed under the authority of the board of directors would be valid, a mortgage executed by the president and cashier under the corporate seal, without the authority or concurrence of the board of directors, was not a valid instrument. The reasoning on which the cases cited were decided applies to the case now before the court. The plaintiff by his judgment and the execution thereon, has acquired a lien on all the property of the corporation; and I cannot find in principle any distinction between a mortgage or conveyance of the lands of a corporation and a judgment upon bond and warrant of attorney upon which the property, real and personal, of the corporation is taken. Such a transaction is not within the ordinary business of a corporation, which the president, as its executive officer is, in virtue of his office, authorized to transact. There are cases in which the powers of an officer of a corporation, and his authority to act for the company, are enlarged beyond those powers which are inherent in his office. But these are cases in which the agency of the officer has arisen

Court of Errors and Appeals of New Jersey has held that such a judgment did not acquire validity from the fact that the money advanced by the plaintiff was applied for the benefit of the company. "From that fact," it was said, "a debt would arise and

an obligation on the part of the corporation to pay the debt in common with its other debts would result; but the plaintiff cannot hold his security which gives him a lien upon the company's property, unless his security is a valid security thereon, especially when the rights of the other creditors are involved." [1] The facts that a president owned the bulk of the capital stock of a corporation, and that he was the superintendent of its business and its treasurer, as well as the active manager of its affairs, and had been accustomed to borrow money for the use of the corporation, it has been held would not give him power to incumber its property by mortgage or confession of judgment for money borrowed.[2]

§ 153. The same subject — Illinois. — The Illinois Appellate Court has said, as to the power of a president of a corporation to confess judgment: "We think it plain, both upon principle and from the authorities, that the president of a corporation has not, as a matter of law, and simply by virtue of his office as president, authority to either confess judgment against such corporation or execute a warrant of attorney empowering another so to do. Such matters form no part of the ordinary business of the company which the president, as its executive officer, is authorized to transact *virtute officii*. The power in question is not inherent in or incident to the office from either usage or necessity.[1]

from the assent of the directors, presumed from their consent and acquiescence in permitting the officer to assume the direction and control of the business of the company. Taylor on Corp. 202, 236–244; Ang. & A. on Corp. §§ 299–302. Thus, when, in the usual course of the business of a corporation, an officer has been allowed in his official capacity to manage its affairs, his authority to represent the corporation may be implied from the manner in which he has been permitted by the directors to transact its business. Martin *v.* Webb, 110 U. S. 7. These are simply instances of the application of the principle that usual employment is evidence of the powers of an agent, and a responsibility will be laid upon the principal for the acts of his agent within the apparent authority so conferred upon the agent — a doctrine which has come to be applied to corporations in many respects as well as to individuals, and with the same qualifications and limitations." The court then applied these principles to the case at bar, saying: "But the depositions laid before the court do not bring the case in hand within the range of the authorities above referred to. The only proof on that subject is that Cook [the president of the company] was the owner of all the capital stock of the company except two shares; that he was president and treasurer and the active manager of the company, using the money of the corporation as he saw fit, and borrowing money for the company so far as its banking business was concerned; that at one time he effected a loan upon mortgage, but that the mortgage was made by the authority of the directors, and that he never undertook to execute in the corporate name papers of the character of the security in question, without the assent of the directors, except in this instance. * * * Incident to the power of Cook to borrow money for the company's use was the power to secure the debt in the usual way; but the power to contract the debt did not carry with it the power to incumber the company's property by a mortgage or judgment confessed as a security for its repayment."

[1] Stokes *v.* New Jersey Pottery Co., (1884) 46 N. J. Law, 237; citing Hackensack Water Co. *v.* De Kay, 9 Stew. Eq. 548.

[2] State Bank *v.* Holcomb, 7 Halst. 196.

[1] Joliet Electric Light & Power Co. *v.* Ingalls, (1887) 23 Ill. App. 45; citing Stokes *v.* New Jersey Pottery Co., (1884) 46 N. J. Law, 237; Thew *v.* Porcelain Mfg. Co., 5 S. C. 415. The court, in Joliet Electric Light Co. *v.* Ingalls, *supra*, discussed the facts and the law applicable to them in the case in these words: "It is one of the elements of a *prima facie* case that it is subject to be rebutted and destroyed by evidence to the contrary. The case of the defendant in error is not that of a stranger to the corporation dealing with the agents of the corporation and without actual notice of the power and authority given to such agents by the corporation or its directors. It would in many instances be difficult and even impossible for such stranger to ascertain with certainty and precision what the proceedings of the corporate board were. As between such third party and the corporation the rule sometimes applies that where one of two innocent parties must suffer for the unauthorized act of an agent the loss should follow [fall on?] him who selected the agent. Taylor on Private Corporations, § 203. Here defendant in error was himself a member of the board of directors of the [corporation], and present at and participating in its meeting of the [date of this action of the officers], and, moreover, was secretary of the company, and kept and had the custody of the record of the proceedings of such meeting. He had actual and full notice that all that the board of directors did on that occasion was to accept without qualification the written offer that he himself had made for the sale of the plant of [another electric light company], and on the very terms proposed by himself, and also that the only papers the board authorized the president to execute, and himself as secretary to affix the seal of the corporation to, were 'the necessary papers to complete said contract.' What contract? Evidently the contract shown by the written proposition of defendant in error to sell the plant for [a fixed sum], payable as stated therein, 'and secured by notes and mortgage or other instruments upon all the plant offered' for sale, and by the resolution of the board accepting the said proposition. It would seem the reasonable construction of the transaction must necessarily be as shown by the offer and the simple acceptance thereof without qualification or counter offer, that the completed contract between the parties was, that in respect to security for the purchase money the special terms proposed, *i. e.*, 'notes and mortgage upon all the plant,' constituted the contract, and that under the agreement defendant in error could have demanded nothing more or other than notes and mortgage, and that a tender by plaintiff in error of such

§ 154. Where contract of purchase includes giving a judgment note.— In a case where a corporation wishing to purchase property for its use, contracted for advances of money for the purpose for which the corporation was to execute its note with a warrant of attorney to have judgment on the same, the Supreme Court of Illinois fully considered the propriety of the judgments upon this particular note, the authority of the officers in the matter and the execution of the notes, and declared the following rules in such case to be that: Where the president of a corporation is authorized to enter into a contract, under which another is to loan the corporation money, and the president is to make and deliver, on its behalf, a note for the money loaned, secured by a warrant of attorney to confess judgment, and such contract is entered into, and the president, in pursuance of its provisions, gives the warrant of attorney, the act will be binding on the corporation, even in the absence of the adoption of any resolution empowering him to give the warrant of attorney.

notes and mortgage would have been in full payment of the contract made. Even if instruments other than 'notes and mortgage' could rightfully have been asked for under the contract, yet it is plain they must necessarily have been instruments which, when given, extended to and covered the plant of the [other corporation] and no more, the words 'upon all the plant offered' being words of limitation. It can hardly be successfully contended that under an executory agreement to give 'notes and mortgage,' payment notes, or notes with warrants of attorney attached or incorporated, authorizing confessions of judgment, can be demanded. The expression 'notes and mortgage' must be presumed to have been understood by the contracting parties in their usual, ordinary and natural sense, and as indicating only simple promissory notes secured by a mortgage upon property. One condition, then, is that warrants of attorney were not called for or included in either of the expressions used in the proposition submitted to the board of directors and accepted by them; that defendant in error had ample notice that the authority given by the board of directors to the president of the corporation to execute papers and to the secretary to affix the corporate seal thereto, was, by the order of said board, expressly limited to such papers as were necessary in order to carry into effect the contract made, and further, as has been already stated, that there was no inherent power vested in the president, *virtute officii*, to give a judgment note that would bind the company. In the case of Hoyt *v.* Thompson, 5 N. Y. 320, it was held that a deed formally executed under the corporate seal, and bearing upon its face the presumption that it was executed by the competent authority from the corporation, was void, and not the deed of the corporation, because it was actually executed by the executive officers without authority, and known by the grantee to have been so executed. The same rule has application to the matter now in hand."

Where a promissory note and warrant of attorney are executed in the name and under the seal of a corporation, it will be presumed that such instruments were properly executed by the authority of the corporation. The common seal of a corporation being affixed to an instrument, and the signatures of the proper officers being proved, the courts will presume that the officers did not exceed their authority; the seal itself is *prima facie* evidence that it was affixed by proper authority. Where a private corporation allows its managing officer to so conduct himself, in his dealings and transactions on behalf of the company, as to lead the public, or those dealing with him, to reasonably believe him as possessing certain powers, the company will not be allowed to question such apparent power or authority as against one relying in good faith on the same. If an act performed by an agent of the corporation would, under any circumstances, be within the authority delegated to the agent, a person dealing with him on the faith of his apparent powers, and without a notice of facts showing that the act was unauthorized, may hold the principal liable, whether the act was authorized or not. In giving a note and power of attorney to confess thereon by a corporation, with the president as security, all the papers were properly executed, except that the corporate name was not signed to the note. Afterwards the secretary of the company, by the direction of the president, put the name of the company to the note. Such action was held sufficient to cure the defective execution of the note, especially when the power of attorney in terms imposed on the corporation the duty to pay this note.[1]

[1] McDonald *v.* Chisholm, (1890) 131 Ill. 273; s. c., 23 N. E. Rep. 596. The power of a president of a corporation to confess judgment for it without authority from the directors, has been questioned in Jones *v.* Avery, 50 Mich. 326; s. c., 15 N. W. Rep. 494. The power to confess judgment for the corporation has been held not be in its treasurer. Stevens *v.* Carp River Iron Co., 57 Mich. 427; s. c., 24 N. W. Rep. 160. As to the authority of a president of a corporation to confess judgment against the corporation, see Raub *v.* Blairstown Creamery Assn., (N. J. 1894) 28 Atl. Rep. 384. As to confession of judgment under a warrant signed by a director, the treasurer and general manager of a corporation without authority of the board of directors or an executive officer, see Jackson *v.* Cartwright Lumber Co., 2 Pa. Dist. Rep. 680. See, on confession of judgment by officer, Adams *v.* Crosswood Prg. Co., 27 Ill. App. 313; Freeman *v.* Plaindealer Co., 9 Luz. Leg. Reg. 37; McMurray *v.* Oil Co., 33 Mo. 377. In Chamberlin *v.* Mammoth Mining Co., (1854) 20 Mo. 96, it was held that the president of a mining corporation might appear and confess judgment for the corporation.

§ 155. What raises a presumption of authority.— The common seal of a corporation being affixed to a deed, as an assignment for the benefit of creditors, and the deed being signed by the officers authorized by the charter to sign it or attest its contracts, raises the presumption that the instrument was executed by the authority of the corporation. Any one assailing it must show its invalidity.[1] When the common seal of a corporation is affixed to an instrument in writing purporting to be executed by it, and the signatures of the proper officers of the corporation are affixed to it and proved, courts will presume that the officers did not exceed their authority, and the seal itself is *prima facie* evidence that it was affixed by proper authority.[2] In the absence of the common seal of a corporation or of proof of facts from which the existence of a resolution of authorization, or of the authority itself may be inferred, the authority of the officers of a corporation to execute a conveyance can only be established by resolution of the managing board, entered in the proper book of the corporation.[3]

§ 156. Power of officers acting conjointly.— The government and direction of the affairs of a corporation being vested by statute in a board of not less than five, of which a majority "shall form a board and shall be competent to transact the business of the company," such majority, when assembled, though without notice to the others, possess all the powers of the board, as in this case, to authorize a sale of the stock of the corporation.[4] There being no charter provision to the contrary, it will be presumed that the president, secretary and treasurer of a corporation are authorized to make all necessary contracts in transacting the ordinary business of the corporation, within the legitimate scope, objects and purposes of its organization.[1] The president and secretary of a corporation are proper officers to agree on its behalf upon an arbitration.[2] There being in manufacturing and trading corporations a power to borrow money, as incident to their power to purchase stock and materials, and to give security by pledging the property so purchased, and as corporations can act only by their officers, the treasurer and general agent of a corporation unitedly have power to borrow money for the use of the corporation, give its negotiable note and pledge its personal property for the same, as well as to execute the necessary documents, notwithstanding the by-laws of such corporation give these officers specific powers not including such acts as are above referred to.[3] A corporation may bind itself by a note and mortgage, made by its president and secretary and signed by them in their official capacity as such.[4] The president and secretary of a manufacturing corporation, even if the powers of general managers be conceded them, though they may bind the corporation to any debt within the scope of its ordinary business, cannot bind it to assuming another and distinct corporation's debts, nor by a promissory note for the payment of such a third party's debt.[5] The president and secretary of a corporation are presumed to

[1] Thorington *v.* Gould, (1877) 59 Ala. 461. BRICKELL, Ch. J., said: In Bank of United States *v.* Dandridge, 12 Wheat. 70, it is said, after referring to the presumptions indulged for and against natural persons: "The same presumptions are, we think, applicable to corporations. Persons acting publicly as officers of the corporation are to be presumed rightfully in office; acts done by the corporation which presuppose the existence of other acts to make them legally operative are presumptive proofs of the latter." Again, "if officers of the corporation openly exercise a power which presupposes a delegated authority for the purpose, and other corporate acts show that the corporation must have contemplated the legal existence of such authority, the acts of such officers will be deemed rightful, and the delegated authority will be presumed."

[2] Southern California Colony Association *v.* Bustamente, (1877) 52 Cal. 192; Bliss *v.* Kaweah Canal & Irrigation Co., 65 Cal. 502.

[3] Southern California Colony Association *v.* Bustamente, (1877) 52 Cal. 192.

[4] State ex rel. Page *v.* Smith, 48 Vt. 266.

[1] Eureka Iron, etc., Works *v.* Bresnahan, 60 Mich. 332; s. c., 27 N. W. Rep. 524.

[2] Fitch *v.* Constantine Hydraulic Co., 44 Mich. 74; s. c., 6 N. W. Rep. 91.

[3] Fay *v.* Noble, (1853) 12 Cush. 1. In Leonard *v.* Burlington Mutual Loan Association, (1881) 55 Iowa, 594; s. c., 8 N. W. Rep. 463, the corporation was held liable for money had and received on account of sums advanced to its secretary and manager and by him paid into its treasury, notwithstanding this officer was at the time a defaulter and not authorized to borrow money on its account.

[4] Rowe *v.* Table Mountain Water Company, (1858) 10 Cal. 441; approved in Verzan *v.* McGregor, 23 Cal. 339, 347.

[5] Rahm *v.* King Wrought Iron Bridge Manufactory of Topeka, (1876) 16 Kans. 277. In Stark Bank *v.* U. S. Pottery Company, (1861) 34 Vt. 144, is was held that the assuming of a debt of a third person was not within the ordinary power of the treasurer of a corporation, it not being in the usual course of business, and to bind the corporation, it would be necessary to show some special authority granted him to do so. Further, that the directors of the corporation had no power to assume such a debt except in case of urgent necessity, which was a question of fact for the jury.

have authority to execute a promissory note in the name of the corporation, and the holder of such a note will not be affected by the fact that such authority did not exist, unless he is shown to have had notice thereof.[1]

§ 157. An illustration on this subject.— The Florida Supreme Court has held that the assignment of a note payable to the order of a corporation, and the mortgage given to secure its payment by the president and secretary of the corporation, was, upon its face, the act of the corporation through their officers, and not their individual acts.[2]

[1] American Exchange Nat. Bank *v.* Oregon Pottery Co., (1892) 55 Fed. Rep. 265. See, also, Merchants' Bank *v.* State Bank, 10 Wall. 644; Crowley *v.* Mining Co., 55 Cal. 273. In Furniss *v.* Gilchrist, 1 Sandf. 53, the transfer of a note transferable by delivery by the president and secretary of a corporation was held to be valid.

[2] Lay *v.* Austin, (1889) 25 Fla. 933; s. c., 7 So. Rep. 143. The court declared the following rules established by the authorities which governed them in their conclusions: "Where a note is payable to a corporation by its corporate name, and is indorsed by an authorized agent or official with the affix of his official position, it will be regarded that he acts for his principal disclosed on the paper as the payee, and who, therefore, is the only person competent to transfer the legal title. Daniel on Negotiable Instruments, § 416; Randolph on Commercial Paper, § 145. An indorsement by an officer of a corporation is *prima facie* the act of the company. Randolph, § 368; Frye *v.* Tucker, 24 Ill. 180. In McIntire *v.* Preston, 5 Gilman, 48, a note payable to a corporation was assigned thus: 'Without recourse. Joel Scott, Secy.,' and it was held that when properly filled out, as the plaintiff might do on the trial, it was sufficient to pass the legal title to the note, and that the authority of Scott, the secretary, to assign it could only be questioned by plea. See, also, Goodrich *v.* Reynolds, Wilder & Co., 31 Ill. 491. Northampton Bank *v.* Pepoon, 11 Mass. 288, decides the same where the indorsement was in blank, by an authorized attorney signing his name and styling himself attorney. Folger *v.* Chase, 18 Pick. 63, was a case where a note was indorsed by the payee to a bank, and its cashier indorsed it as follows: 'P. H. Folger, Cashier,' and it was objected that the latter indorsement was not made in the name of the corporation; but, said the Supreme Court of Massachusetts, we think the indorsement by the cashier, in his official capacity, sufficiently shows that the indorsement was made in behalf of the bank, and if that is not sufficient the plaintiffs have the right now to prefix the name of the corporation. Nicholas *v.* Oliver, 36 N. H. 218, decides that the indorsement, 'W. Earle, A. Secy., made on a promissory note payable to an insurance company, is to be considered the indorsement of the company, if nothing further appear to indicate that it is intended as the indorsement of some other party. In Russell *v.* Folsom, 72 Me. 436, the indorsement by the treasurer of the payee corporation signing his name and an abbreviation of his office was held to transfer the legal title, and in Farrar *v.* Gilman, 19 Me. 440, the indorsement by the cashier of the bank was adjudged to be *prima facie* evidence of a legal transfer of a negotiable note. See, also, Chase *v.* Hathorn, 61 Me. 505; Dunn *v.* Weston, 71 Me. 270; Elwell *v.* Dodge, 33 Barb. 336; Marine Bank *v.* Clements, 31 N. Y. 33."

§ 158. Another illustration — one holding several offices. —The by-laws of a Michigan manufacturing corporation provided that one person might hold the offices of president, treasurer and general superintendent, and vested in the president the general supervision of the property and affairs of the corporation, and in the treasurer the custody of its funds and valuable papers, with power to collect and pay out all moneys and sign all acceptances and notes in its behalf, while the superintendent was given general supervision and management of its affairs, subject to the president and board of directors, with power to make all contracts in its behalf, except when otherwise provided by the by-laws. The same person held the three offices for five years, and managed and controlled the affairs of the corporation, if not without advice, certainly without objection, on the part of the stockholders or directors. He finally assigned to a bank to secure existing indebtedness and that which should be thereafter incurred, one hundred and fifty thousand dollars of good and collectible accounts, then existing or thereafter acquired, to be held by the bank as collateral security for existing and future indebtedness of the corporation. The corporation afterwards making an assignment for the benefit of its creditors, the bank filed a bill to enforce the agreement. The Supreme Court of Michigan held that the agreement was one which the president, treasurer and superintendent had the power to make and that it was enforceable in equity.[1]

[1] Preston National Bank of Detroit *v.* George T. Smith Middlings Purifier Co., (1890) 84 Mich. 364; s. c., 47 N. W. Rep. 502. Champlin, Ch. J., dissented solely upon the ground that the contract was too uncertain and indefinite to be specifically enforced. *Arguendo*, as to the authority of this holder of the three positions, it was said by Cahill, J., for the court: "Conceding that the president must exercise his powers of management in subordination to the board, yet when, as in this case, the stockholders, being the owners, have seen fit to vest certain extraordinary powers of management in the president, and certain other powers in the treasurer and superintendent, and the directors, with full knowledge of this, elect a man to fill all those offices, and thereafter put no restraint upon his management, the board must be held to have consented to his exercising all the power reasonably included in the language by which it was conferred. Bank *v.* Comegys, 12 Ala. 772. The right of the directors to make the security in question is not disputed, yet their authority is given in language no broader than that which defines the duties of the president. If

§ 159. Note executed by a secretary.— In an action against a corporation on a promissory note, signed by one whom the evidence tended to show was the secretary of the corporation and impressed with a stamp which appeared to have been used as the seal of the company, there being evidence that the plaintiff had advanced to the corporation the amount for which the note was given, the Supreme Court of New York, in General Term, held that a finding that the corporation had executed the note in consideration of money loaned to it would not be disturbed.[1]

it be said that the stockholders could not thus usurp the powers of the board and confer them on the president it may be said that the right of the directors to delegate certain of their powers of management to the officers is undoubted, and if the consent of the board was needed to fully invest the president with the power given to him in the by-laws that consent has been given in this case. The question of [the president's] power is largely one of intention on the part of the stockholders and directors. As bearing upon this question of intention, the fact that no corporate meetings were held for five years after the by-laws were adopted is an important circumstance. It is claimed that the neglect to hold corporate meetings can have no bearing on this case, because it is not shown that complainant knew of this fact or was influenced by it, and we are referred to the case of New York Iron Mine *v.* Negaunee Bank, 39 Mich. at page 655, where some language of Mr. Justice COOLEY to that effect is found. In that case the only question was whether the bank had been influenced to rely upon Wetmore's apparent authority, which did not in fact exist, to make the paper in question. The question is different here. It is not one of apparent power to do an act conceded to be fraudulent and void unless the corporation was estopped by its conduct to allege the fraud, but it is a question of actual power in Mr. Smith, as the president, treasurer and manager of this corporation, to perform an act entirely legal and proper if authorized. The intention to confer such power may be evidenced by their failure to act in opposition to or in restraint of a course of business they have themselves permitted, if not established. It is an ordinary occurrence for manufacturing or trading concerns, whose products have sometimes to be carried to await a favorable market, to draw against such products for the money needed to carry them; and, if requested, some form of security upon such products is given. If this be permissible shall the right to give security exist only so long as the goods are in stock, or may they be sold on credit and the accounts due for such sales be substituted with the consent of the creditor? If not, then trade is hampered, the debtor is put into the hands of the creditor, and the latter cannot release him if he would without risk. The right of Mr. Smith, as president and treasurer, to borrow money for the legitimate needs of the business and to give the company's paper is not contested. The duty to pay is involved in the power to incur debts. In the case of this corporation its power to pay its debts depended on the profitable sale of its products and the collection of the money due on such sales. If it could not otherwise dispose of its products it could turn them out to its creditors in payment of, or as security for, such debts. If its goods were sold on credit, these credits stood as the representatives of the goods, and the same use could legitimately be made of them. This is not like giving security upon all the corporate property, the enforcement of which may involve the corporate existence. The giving of the security or its enforcement did not necessarily interfere with the prosecution of the corporate business. It was given

§ 160. Power of superintendents, etc.— A corporation will be bound by a contract made by its superintendent and manager in this manner, to meet its financial necessities, was strictly within its authority as a corporation, and it was equally within its power, after having obtained it, to execute and deliver the note which was the subject of the action for payment of the amount. It is true that it was not subscribed by the president, as contracts were authorized to be made by article 7 of the by-laws; but while the president did not subscribe the note, his conduct authenticating its subscription, in the name of the company, was equal to what was in this manner provided for, inasmuch as he directed the note to be made by the secretary. These persons were vested with the apparent authority for conducting and carrying on the business of the company. And even though they may have omitted literally to comply with the by-laws, as to the form of the contract for the payment of the money, the company itself cannot be shielded from liability on account of that omission of its controlling officers. The case in all its features differs from that of Bank *v.* Church, 39 Hun, 498, where the note was neither sanctioned by the corporation, nor given by the officers conjointly required to act in the transaction of its business. The present note was the act of the officers, conjointly, of a business corporation empowered to borrow money and provide for its payment, substantially the same as that might be done by an unincorporated partnership."

upon property and credits already devoted in equity and good conscience to the payment of its creditors, of whom the bank was one. The effect of it was simply to give complainant priority of lien." The court referred to the following cases to which it was cited, to wit: Kimball *v.* Cleveland, 4 Mich. 606; Joy *v.* Plank Road Co., 11 Mich. 155; Peninsular Bank *v.* Hanmer, 14 Mich. 208; Adams Mining Co. *v.* Senter, 26 Mich. 73; New York Iron Mine *v.* Negaunee Bank, 39 Mich. 644; Star Line *v.* Van Vliet, 43 Mich. 364; New York Iron Mine *v.* Citizens' Bank, 44 Mich. 357; Eureka Iron & Steel Works *v.* Bresnahan, 60 Mich. 332; Dwight *v.* Lumber Co., 67 Mich. 507; Delta Lumber Co. *v.* Williams, 73 Mich. 86; Genesee Co. Savings Bank *v.* Michigan Barge Co., 52 Mich. 438; Kendall *v.* Bishop, 76 Mich. 634; Stokes *v.* Pottery Co., 46 N. J. L. 237; Bank *v.* Bank, 48 N. J. L. 527; s. c., 7 Atl. Rep. 318; Fay *v.* Noble, 12 Cush. 1, as to the powers of agents of corporations in such matters. They said: "They are not altogether free from conflict, although if the exact point necessary to be decided in each case be kept in mind, and the language used be given no broader meaning than the facts of the particular case require, the conflict will be found more apparent than real."

[1] Jansen *v.* Otto Steitz New York Glass Letter Co., (1888) 49 Hun, 606; s. c., 1 N. Y. Supp. 605. DANIELS, J., for the court, said: "To obtain money

relating to the ordinary concerns of its business.[1] It may be shown by the testimony of any one who knows the fact that one is the general manager of a corporation.[2] A corporation which has authorized its agents to sign "all notes and business paper," will be liable on accommodation notes given by him in the name of the corporation to a *bona fide* holder, taking them in good faith, for value before maturity, notwithstanding any want of authority of the agent to execute them for the purposes for which they were given.[3] The business manager of a manufacturing corporation cannot be assumed, as a matter of law, to have implied authority to agree, in behalf of the corporation, to pay for medical attendance, however small the sum, on one whom he has reasonable ground to believe to have been injured by the fault of the corporation.[4] An engineer employed by a railroad corporation, by virtue of his position, has no power to bind the corporation by his contracts.[1] To bind the corporation special authority to the engineer must be shown.[2] The secretary of a corporation has no authority to give a memorandum of indebtedness of the corporation, and such a memorandum would not be negotiable.[3] The unauthorized execution of a promissory note by the secretary of a corporation for money borrowed, may be ratified by the board of directors of the corporation authorized by its by-laws to borrow money and execute securities therefor, and the corporation be bound by such ratification.[4] It is in the power of the supervising agent of a corporation, made by its charter its executive officer, having the care and management of its business under the direction of the general board of directors, to accept a draft for the corporation where there is no restriction upon the general powers conferred upon him.[5]

[1] Whitaker *v.* Kilroy, (1888) 70 Mich. 635; s. c., 38 N. W. Rep. 606.

[2] Corning *v.* Walker, 14 N. Y. Wkly. Dig. 314. In Negley *v.* Counting Room Company, (City Ct. N. Y. 1886) 1 N. Y. St. Repr. 299, the evidence that the agent of a corporation signing a promissory note as "manager," "had mostly the entire charge of the business," has been held sufficient to show that his act in executing the note was within the scope of the general powers conferred upon him, and incidental to, and necessary for, the conduct of the corporation's business. Citing Farmers' Bank of Bucks County *v.* McKee, 2 Pa. St. 318.

[3] Bird *v.* Daggett, (1867) 97 Mass. 494.

[4] Swazey *v.* Union Manufacturing Co., 42 Conn. 559. As to the power of an officer of a corporation authorized to draw checks and drafts, and charged with the general management of the business of the corporation, in the absence of contrary instructions by the board of directors to bind the corporation by notes given for moneys used to pay off indebtedness of the corporation, which was a railroad corporation, in the construction of its road, see Fitzgerald & Mallory Construction Co. *v.* Fitzgerald, (1890) 137 U. S. 98; s. c., 11 Sup. Ct. Rep. 36. Cases as to the power of a president of a corporation growing out of his being, in the management of its affairs, its managing officer. Siebe *v.* Joshua Hendy Machine Works, 86 Cal. 390; s. c., 25 Pac. Rep. 14; Lancaster County *v.* Cheraw & C. R. R. Co., 28 S. C. 134; s. c., 5 S. E. Rep. 338; Kenton Insurance Co. *v.* Bowman, 84 Ky. 430; s. c., 1 S. W. Rep. 717; Marlatt *v.* Levee Steam Cotton Press Co., 10 La. 583; s. c., 29 Am. Dec. 468; Topeka Primary Assn. *v.* Martin, 39 Kans. 750; s. c., 18 Pac. Rep. 941; Bambrick *v.* Campbell, 37 Mo. App. 460; Grafius *v.* Land Company, 3 Phil. 447; Ceeder *v.* H. M. Loud & Sons Lumber Co., 86 Mich. 541; s. c., 49 N. W. Rep. 575; 24 Am. St. Rep. 134; Chicago, etc., R. R. Co. *v.* Coleman, 18 Ill. 297; s. c., 68 Am. Dec. 544; Steamboat Company *v.* McCutcheon, 13 Pa. St. 13; Smith *v.* Smith, 62 Ill. 493; Richmond, etc., R. R. Co. *v.* Snead, 19 Gratt. 354; s. c., 100 Am. Dec. 670; Dougherty *v.* Hunter, 54 Pa. St. 380; Moser *v.* Kreigh, 49 Ill. 86; Chicago, etc., R. R. Co. *v.* Boone Co., 44 Ill. 247; Voris *v.* Renshaw, 49 Ill. 425.

[1] Gardner *v.* B. & M. R. R. Co., 70 Me. 181.

[2] Ibid.

[3] Sears *v.* Trustees Illinois Wesleyan University, (1862) 28 Ill. 183.

[4] Nebraska & K. Farm Loan Co. *v.* Bell, 58 Fed. Rep. 326; s. c., 7 C. C. A. 253.

[5] Hascall *v.* Life Association of America, 5 Hun, 151. As to the power of a superintendent of a corporation operating in a foreign country, see Rathbun *v.* Snow, (1890) 123 N. Y. 343.

§ 161. A manager's power.— In a case where one as manager of a corporation, to which position he had been duly appointed, negotiated a loan with another, and gave the latter his note for the amount payable to the order of the corporation, which note was indorsed by him as such manager, and as collateral security for its payment he delivered with the note mortgage bonds of the corporation, the New York Court of Appeals said the evidence "was sufficient to permit the court to submit, as it did to the jury, the question whether the debt, to recover which this action was brought, was that of the company." The court below was requested to charge that before a verdict could be found for the plaintiff the jury must be satisfied by affirmative proof that the manager was authorized to indorse the name of the company on the note by prior resolution of the executive committee or by the board of directors or by ratification, by resolution or some equivalent act of such committee or bond. The court held that there was no error in the charge, which substantially was that the jury, to reach such result, must find either

prior authority or subsequent ratification, and that it could be evidenced by general course of business as well as by resolution.[1]

§ 162. Manager of a foreign incorporation.— Certain notes were signed by the president of a construction company, an Iowa corporation, and certain others by an auditor of the corporation, payable to the order of certain banks, and indorsed by one who was appointed a manager for the construction company in its work of constructing railways in Nebraska. Upon these notes the latter realized money through the banks and used it in payment of bills of the construction company for labor, etc., on their work of construction. When the notes became due this manager in Nebraska arranged or paid off the notes as indorser, and they were assigned over to him. He brought action upon them against the company in the Nebraska courts, and the foreign corporation defendant had the cases removed to the federal courts. When the case came before the Supreme Court of the United States, in the opinion rendered, FULLER, Ch. J., for the court, said of the evidence, that it "tended to show that Mallory [the president of the construction company] was authorized to build the line of [several railroad companies], being a distance in the aggregate of about six hundred miles of railroad, and which cost some seven millions of dollars; that he had full charge of the location and construction of the road; that he was authorized to draw checks and drafts, and all these notes and drafts were made, accepted or authorized by him; that the directors not only did not give contrary instructions in the first instance, but knew of the giving of the notes and drafts, and did not disaffirm the action of the president, and that the proceeds were used for the payment of construction liabilities of the company in every instance, either directly or in taking up paper, the proceeds of which had been so used." The argument before the court was

[1] Huntington *v.* Attrill, (1890) 118 N. Y. 365; s. c., 23 N. E. Rep. 544. In Deller *v.* Staten Island Athletic Club, (1890) 56 Hun, 647; s. c., 9 N. Y. Supp. 876, it was held that where the board of management of a corporation like defendant was authorized by the by-laws to make necessary contracts and regulations, and the officers of the club, acting under a resolution of the board of management, contracted to lease the club house to plaintiff, who agreed to maintain a restaurant for the exclusive use of the members and their guests, subject to the approval of the house committee, plaintiff might recover for refreshments furnished to guests of the club at the request of members of the house committee.

that there could be no recovery on the notes and drafts in question, because it was said they were made by the president or auditor of the company without the knowledge or consent of the board of directors; and, further, that the notes in the first two causes of action named were paid by the plaintiff when he was under no obligation to pay, and then and in that respect was a mere volunteer. The Supreme Court of the United States held that the instructions to the jury in this case were justified by the evidence.[1]

[1] Fitzgerald & Mallory Construction Co. *v.* Fitzgerald, (1890) 137 U. S. 98; s. c., 11 Sup. Ct. Rep. 36. The instructions of the United States Circuit Court in this case to the jury were as follows: "That if they found from the evidence that the president was given entire management in building the railroad, and in the incurring of liabilities and paying of debts incurred therein, he might appoint other agents, such as a cashier and auditor, for the purpose of making the calculations on pay-rolls and on contracts for building the road, and might empower any one of such agents who made such calculations upon the pay-rolls of the amount due to those who did the work by contract or otherwise, to draw any checks or bills or sight drafts necessary to pay the same, and 'if it becomes necessary for the benefit of said company to execute promissory notes or to draw sight drafts, the said president would have ample authority to do the same, and might likewise empower the cashier, or the party whose duty it was to ascertain the amounts due to contractors, materialmen and persons working upon the construction or building of said railroad by the construction company, to draw drafts or checks, or even make promissory notes, and that the same, if done for the company or for its use and benefit, would be binding upon the said company, unless the president received from the directors certain instructions which limited his authority in the premises.'" The court also instructed the jury: "As to the promissory notes which were indorsed by the plaintiff, and upon which he was held as indorsee, if the jury found from the evidence that said notes were executed in good faith for the president of the construction company, and that the proceeds, or the proceeds of the notes and drafts of which the notes in question were renewals, were received by and used for the benefit of the construction company, and you further find that the plaintiff is not the holder and owner of said notes, you will find for the plaintiff in the full sum of the notes, with interest." And further: "And although there may be a provision in the by-laws of said construction company requiring certain formalities in the execution of a promissory note or draft, yet that does not necessarily make such formalities essential to the ratification of the contract; but if you find from this evidence that said notes were given for the purpose of paying off debts that were due by said construction company, and that the directors of said construction company had full knowledge of the same and assented to this transaction, to the signing and execution of the notes, you will find that said acts of the president have been fully confirmed, and you will find for the plaintiff the full amount of said notes, with interest, provided you find

§ 163. Authority of a manager.— One, a physician, managing a medicine company, a corporation organized under the laws of New Jersey, who had been intrusted with the management so far as the collection of debts due to it and payment of debts due by it, had placed in a bank for collection certain checks payable to the order of the corporation, indorsed in the name of the corporation by himself. The total amount of the collections were paid to him by the bank, and it appeared that a part of the sum he failed to pay over to the corporation or on its account. The corporation brought action against the bank for this balance, denying the authority of this person to indorse, etc., the paper

the plaintiff was the owner of the same, and is now the lawful holder of them." It was said by the Supreme Court on the merits of the case: "If the moneys were used to pay off indebtedness of the company arising in the construction of the road, and for work done under proper authority, the transactions were in pursuance of the authorized purposes of the corporation, and occurred in its legitimate business. The execution of the paper could not be held to be in excess of the powers given, and it was clearly the duty of the directors to give contrary instructions if they wished to withdraw the general management from its president, and to disaffirm the action of their agents promptly and at will, if they objected to it. Indianapolis Rolling Mill *v.* St. Louis, etc., R. R. Co., 120 U. S. 256; Cresswell *v.* Lanahan, 101 U. S. 347. The company was liable upon the original indebtedness, and its change of form in order to relieve the pressure of the creditors was by the direction, with the participation, and the request of, the president. We perceive no want of power and no omission of essential formalities in what was done. Another mere fact that [the plaintiff] was a stockholder in and a promoter and director of the company, and, with the president, the manager of the work in the prosecution of which the indebtedness arose, would not change the binding character of the obligation. Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587; Gardner *v.* Butler, 30 N. J. Eq. 702, 721; Harts *v.* Brown, 77 Ill. 226; Again, there was evidence to the effect that [the plaintiff] indorsed the notes at the request of the president. Inasmuch as the defendant was answerable for the indebtedness which the money received upon the notes went to pay, if in order to obtain that money [the plaintiff] was called on to indorse the notes, and compelled to protect his indorsement, he could not be treated as a volunteer. There would be no element in such a transaction of the voluntary payment by one of another's debt. So, if [the plaintiff] was the manager of the work under the president, and the money was used to pay off the sub-contractor, materialmen and hands, then, upon the refusal of the company to repay, [the plaintiff] had the right to take up the notes and have them assigned to him; and whether he was the owner and holder of the notes was left to the determination of the jury. By the first section of the by-laws, the officers of the company were declared to be 'a' president, vice-president, secretary and treasurer, and such other officers as may be deemed necessary to carry out the object of the articles of this incorporation."

belonging to the company, and claiming that such authority was only in its treasurer. The trial court refused the request of the bank on the trial to instruct "that if the jury shall find that by the consent of the [corporation this person] had conducted the plaintiff's business, had paid bills, sold goods, received and paid out moneys for the [corporation], and was in fact ostensibly in charge of the business, then [he] had apparent authority to indorse the drafts in question and receive the money in question, and it was immaterial whether or not he had actual authority." The Supreme Court of New York, in General Term, held that this refusal to instruct, as requested, was error, for, said they: "Corporations can act only through their officers and agents, and, if a person has been instructed by the officers to carry on the business, the acts of that person must be deemed to be binding upon the corporation in all cases where the parties dealing with him have not notice or knowledge of his want of actual authority."[1]

[1] Craig Medicine Co. *v.* Merchants' Bank of Rochester, (1891) 59 Hun, 561; s. c., 14 N. Y. Supp. 16. But the court considered another point a more radical reason for reversing this judgment, to wit: It appeared that the treasurer had been given a proxy by the other stockholders to represent them in the meeting to be held in New Jersey to organize the corporation and to vote for them. This he did, organizing the company, electing himself and the persons he represented as a board of directors, he only being present, and afterwards, in a meeting of its board of directors represented by himself alone, elected officers, including himself as treasurer. It was said as to the law applicable to this state of facts: "We know of no principle applicable to the discharge of corporate functions, by which directors or trustees of the corporation can vote at the meeting of the board of directors or trustees by proxy. Under the act of this state (Chapter 40, Laws of 1848) for the organization of companies for manufacturing, mining, mechanical or chemical purposes, stockholders may, at the meeting of the stockholders for the election of directors, vote when absent by giving a written proxy to some other person. This is also true of the statutes of New Jersey, put in evidence, but there is no law in New Jersey that permits a director to vote by proxy at board meetings. The general rule there, as in this state, and universally, is that it requires a quorum of directors or managers as trustees of a corporation to transact business, and that, in the absence of a statute making a different number such quorum, a majority of the whole board is required. The principal claim, therefore, made by the plaintiff, that it had a legally elected treasurer, who alone could transact business of the corporation of this character, cannot be maintained. The proxy or power of attorney, put in evidence, did not give [its holder] the right to vote in the name of the directors who should be chosen at the stockholders' meeting, and if it had, it would have been utterly void. It was not known, indeed, who the directors would be. Under the power of attorney [he] had

§ 164. What is not within the duties of a cashier of a corporation.— The Michigan Supreme Court has declared in a case before it that compromising claims, settling unliquidated damages, and releasing debts due to the corporation, are acts which do not come within the ordinary duties of a cashier, book-keeper, or corresponding clerk.[1]

the right to elect other persons than those whom he did in fact designate as directors. In the absence, therefore, of a legally authorized treasurer, any person in the position of [the person here] who had general management of the business, or any director, as [the one who signed for him] is shown to be, had the power to indorse the corporation's name for the purpose of collecting commercial paper made payable to its order. The [bank], having acted in perfect good faith, has turned its collections over to the proper person representing the corporation. There being no treasurer by election of the directors, and none in fact by the usual conduct of the business, except the person acting for the [corporation] in this instance, it follows that the manager or any director of the corporation could, in the absence of a positive statute, sign the corporation name for the purposes of the collecting of commercial paper."

[1] Delta Lumber Co. *v.* Williams, (1888) 73 Mich. 86; s. c., 40 N. W. Rep. 940. *Arguendo*, the court said: "The statute authorizing the formation of corporations for manufacturing purposes enacts that the stock, property, affairs and business of every such corporation shall be managed by its board of directors. The board shall choose one of their number to be president, one to be vice-president, and also a secretary and treasurer. The office of cashier is not one that is named in the act, and although such corporations are authorized to elect, in such manner as they may determine, all necessary officers, and to prescribe their duties, yet no testimony in the case was introduced to show what the duties of the cashier were defined to be. In banking institutions the authority of a cashier has become pretty well defined by common usage. He is considered the executive officer through whom and by whom the whole moneyed operations of the bank in paying or receiving debts, or discharging or transferring securities, are to be conducted. Ang. & A. Corp. § 299. But his authority does not extend so far as to justify him in altering the nature of the debt, or changing the relation of the bank from that of a creditor to that of an agent of its debtor. And an agreement by the president and cashier of a bank, that an indorser shall not be liable on his indorsements, is not binding on the bank. Bank *v.* Dunn, 6 Pet. 51; Bank *v.* Jones, 8 Pet. 16. In the absence of anything in the charter or by-laws of the corporation known as the 'Delta Lumber Company' defining the duties of the cashier of such corporation, and in the absence of any showing as to the usage of this company, or of manufacturing corporations in this state, by which the duties of a cashier may be inferred, we cannot ascribe to him greater powers as an agent of the corporation than would pertain to the agent of a banking corporation. He may be considered the executive officer of the financial operations of the corporation; and whether he would, in an emergency, be considered as authorized to sell and convert the personal property of the corporation into money to meet its obligations, need not now be determined, as certain it is that he would have no authority, as such cashier or general financial agent, to give away the property of the corporation or change its relation with its debtor by releasing a debt due to it, without express authorization. Bank *v.* Dunn, 6 Pet. 51; Kirk *v.* Bell, 12 Eng. Law & Eq. 389; Hoyt *v.* Thompson, 5 N. Y. 320."

§ 165. Auditing board of a corporation.— In the absence of any proof of authority conferred upon an auditing board of a manufacturing corporation of New York, beyond the usual functions of such a board to allow or reject claims, such an auditing board, it has been held, had no authority to rescind a contract which it was claimed in the action against the corporation had been made with a licensor by its president representing the corporation, the licensee of a patented article used in its business, or determine the future action of the corporation, but that such authority was in the trustees of the corporation.[1]

§ 166. Power of a treasurer generally.— Title will pass by a sale made by the treasurer of a corporation, without special authority, where he has been in the habit of transacting such business with the knowledge and sanction of the managing board of the corporation.[2] The authority of a treasurer of a corporation to bind it by the acceptance of a draft, may be inferred from the knowledge and acquiescence of the directors.[3] An attorney may be employed by the treasurer of a corporation without any special authorization of the board of directors.[4] A treasurer of a corporation must have special authority, it not being within the general power and province of such officer, to issue written admissions, which would bind the corporation, of the amount due upon a disputed claim for salary of other agents of similar grade; the power to fix such amounts belongs regularly to the board of directors.[5] The treasurer of a manufacturing corporation has no authority to release a claim for a loss under a policy of insurance obtained by him in behalf of the corporation.[6] A treasurer of a corporation is not authorized to pay a claim of his own against the corporation where it has not been approved and its payment

[1] Skinner *v.* Walter A. Wood Mowing & Reaping Machine Co., (1893) 140 N. Y. 217.

[2] Phillips *v.* Campbell, 43 N. Y. 271.

[3] Partridge *v.* Badger, 25 Barb. 146.

[4] Turner *v.* Chillicothe & Des Moines R. R. Co., (1873) 51 Mo. 501.

[5] Kalamazoo Novelty Manufacturing Co. *v.* McAlister, 36 Mich. 327.

[6] E. Carver Co. *v.* Manufacturers' Insurance Co., (1856) 6 Gray, 214.

authorized by the corporation.[1] On a debt being paid to the treasurer of a corporation he has no power to assign the security without direction from the board of directors.[2] A vote of the directors of a corporation authorizing its treasurer to hire money on such terms and conditions as he may think most conducive to the interests of the corporation to meet certain of the acceptances by him of the drafts of the corporation upon him, carries with it authority to indorse drafts drawn by himself to accomplish the object.[3] Mere lapse of time will not destroy the official character of the last secretary of a corporation so as to prevent his releasing a mortgage given to the corporation.[4] In a case where the authority of a treasurer of a corporation to sell material or products of the same was questioned, and one of the by-laws of the corporation was put in evidence providing that the treasurer "should discharge the duties usually and customarily pertaining to" this officer and other testimony that witness was familiar with the duties of cordage and other manufacturing corporations at the place where the contract was executed and where this particular corporation was located, and that they were accustomed to buy and sell merchandise and to sign and accept contracts such as was made in this case, it was held by the United States Circuit Court of Appeals that the authority of the treasurer to bind the corporation by this contract was one for the jury.[5]

§ 167. Power of a treasurer as to transfer of a note.— In the absence of evidence of authority, the title to a note will not pass by the indorsement of the treasurer of a corporation in his official capacity.[6] A treasurer of a corporation being intrusted by it to take notes, an indorsement by him will bind the corporation, his authority to indorse them being implied from his being treasurer and being intrusted with the securities, and that they are made payable to the treasurer, or to him as treasurer.[1] In case the directors of a corporation by vote authorize its treasurer to indorse notes of the corporation to a third person, or such treasurer be suffered to draw and accept drafts, to indorse notes payable to the corporation, and to do other similar acts whereby he is held out to the public as having the general authority implied from his official name and character, an indorsement of a note made in pursuance of such express or implied authority would pass a valid title to the indorsee.[2]

[1] Peterborough Railroad *v.* Wood, 61 N. H. 418.

[2] Ballou *v.* Campbell, 5 Wend. 572.

[3] Belknap *v.* Davis, 19 Me. 455.

[4] Kimball *v.* Goodburn, 32 Mich. 10.

[5] National Cordage Co. *v.* Pearson Cordage Co., 55 Fed. Rep. 812; s. c., 5 C. C. A. 276. In Ellis *v.* Howe Machine Co., 9 Daly, 78, it was held that the treasurer of the sewing machine company, owning with his brother, the president of the company, nearly the entire capital, had power to bind the corporation by a contract for a statue to be used as an advertisement of its business; that the concurrence in such case of the whole or of the majority of the board of directors was not essential. As to the power of a treasurer of a corporation, see Columbia Bank *v.* Gospel Tabernacle Church, (1889) 57 N. Y. Super. Ct. 149. As to the power of a treasurer of a lumber, ranch and mining company, see Rumbough *v.* Southern Improvement Co., (1893) 112 N. C. 751.

[6] Knight *v.* Lang, 4 E. D. Smith, 381; s. c., 2 Abb. Pr. 227.

§ 168. Power of a treasurer as to execution of a note.— A treasurer of a corporation may be given authority by a corporation by parol to execute a promissory note in its name.[3] Where a treasurer of a corporation has been authorized to give the note of a corporation in payment of a corporate debt, he may do so after the lapse of several years, provided the debt is not barred by the Statute of Limitations.[4] The authority to execute a note of a corporation in an officer of the same may exist under a by-law of the corporation, or be based upon its custom in such matters. If its custom is to permit its treasurer to execute its promissory notes, the corporation will be bound by a note executed by such treasurer, especially where it receives the benefit of the money loaned upon the notes.[5] The board of directors of a

[1] Perkins *v.* Bradley, 24 Vt. 66.

[2] Lester *v.* Webb, (1861) 1 Allen, 34.

[3] Odd Fellows *v.* First National Bank of Sturgis, 42 Mich. 461; s. c., 4 N. W. Rep. 158.

[4] Hayward *v.* Pilgrim Society, (1838) 21 Pick. 270.

[5] Foster *v.* Ohio-Colorado Reduction & Mining Co., (1883) 17 Fed. Rep. 130. McCrary, J., in this case charged the jury in these words: "Upon the first question, as to whether this is the note of the defendant corporation, that is to be determined upon the question whether the person who executed the note on behalf of the corporation, * * * the treasurer of the company, was authorized to execute such an instrument. The law upon this subject is that the authority is not presumed from the mere fact that the person assumed the right to give a note in the name of the corporation. A corporation is an artificial person, which must act within certain limits. It differs from a natural person. If an individual gives his note, it is not necessary to prove anything in the way of authority, but a corporation must act by way of agents, and the authority of the agent who acts for it is not presumed. It may, however, be shown, either by showing an express authority, as, for example, a resolution of the board of trustees authorizing a certain party to execute a note on behalf of the corporation, or by a provision of the constitution or by-laws of the cor-

construction company authorized the officers of the company to execute a note for nine thousand dollars and a chattel mortgage upon the rolling stock of the company to secure the payment of the same. The officers executed the note and mortgage and stipulated therein for attorney's fees in case of suit for the collection of the same. In a suit to foreclose the mortgage, a District Court of Iowa refused to allow attorney's fees. Upon an appeal, the Supreme Court said as to this matter: "This was an explicit direction to execute a note for nine thousand dollars and interest, and no more. The company did not, by any official action, authorize the execution of a note in any amount exceeding said sum in any event. We think the court correctly held that the measure of liability was nine thousand dollars and interest." [1] It is not within the ordinary powers of the treasurer of a corporation, acting as its financial agent, to give the note of the corporation for the debt of a third person; neither is it within the ordinary powers of the directors of a corporation, unless there is an urgent necessity to do so to subserve the interests of the corporation.[2]

§ 169. Authority of a treasurer to borrow money by means of sterling contracts.— In a federal court case the action was *assumpsit* for breach of contract by a railroad company in not placing in the hands of the drawers of a foreign bill of exchange money to meet it when matured. The company's

poration authorizing a certain officer to execute promissory notes. It might be shown in that way, but I believe it is not claimed that there is anything of this kind here. It may also be shown by the course of dealings of the corporation and by facts and circumstances which are sufficient, in the judgment of the jury, to show that the party who executed the note had the authority. If it was the custom of this corporation to permit the treasurer to execute its promissory notes, and if he was in the habit of doing so, with the knowledge of the trustees, or of the corporation — which means, of course, the trustees — they had, by recognizing that custom and acting upon it, themselves become bound by it, and, especially, if they received the benefits of transactions of this sort, which they permitted the treasurer to enter into."

[1] Hardin *v.* Construction Co., 78 Iowa, 729; s. c., 43 N. W. Rep. 543. See, also, Pacific R. M. *v.* Dayton, S. & G. R. Ry. Co., 5 Fed. Rep. 852; s. c., 7 Sawy. 61; Schallard *v.* Eel River Steam Navigation Co., (1886) 70 Cal. 144; s. c., 11 Pac. Rep. 590. For a case showing under what circumstances the signing of a note by the treasurer of a corporation was unauthorized, see Medberry *v.* Short, 15 N. Y. Wkly. Dig. 227.

[2] Stark Bank *v.* U. S. Pottery Co., 34 Vt. 144.

treasurer had borrowed money by the purchase of a foreign bill of exchange and entered into the contract signing the name of the corporation by himself "Treasurer." The question in the case was whether he had authority to bind the corporation in this way. The insistment of the plaintiff was that such authority was to be found in the by-laws of the corporation. Colt, J., in his opinion, recites the by-law's provision that the treasurer "shall collect and receive all assessments, incomes and moneys that may be due to the corporation, and disburse the same as the board of directors may order; he shall surrender notes and other promissory papers on payment thereof, and discharge such mortgages as may have been given securing the same; he shall keep a regular set of books, containing the accounts of the corporation, and of all its funds that may pass through his hands; *and shall lay before the directors monthly a written statement of all notes, drafts, promises, contracts made, signed, indorsed or surrendered by him*, an abstract of all monevs received and paid by him, and a statement of all property bought or sold, and of such other matters as the directors may deem important." He then said: "The fact that this by-law directs the treasurer to lay before the directors monthly a written statement of all notes, drafts, promises and contracts signed or indorsed by him does not, I think, confer upon him the authority to do these acts without their direction or approval. To confer such broad and general powers on the treasurer of a corporation is certainly unusual. The court should not hold that such authority is vested in a treasurer by implication from the language of a by-law, but the by-law should expressly give such authority, if it was intended to be so conferred."[1]

[1] Page *v.* Fall River, W. & P. R. Co., (1887) 31 Fed. Rep. 257, 258, 259. The defendant called several officers of different railroads, who testified that, in their experience, they never knew railroads to borrow money upon such contracts as this; also two presidents and one cashier of Boston banks were called, who testified, in substance, that to their knowledge such contracts were not an ordinary and usual method of borrowing money, and that they had never known of the loan of money on such contracts. On the other hand, the plaintiff introduced evidence that at the time of this transaction the borrowing of money by means of sterling contracts similar to the one now in controversy was a usual and ordinary way of borrowing money in Boston among houses having foreign capital to loan, by persons not importers or requiring to use money abroad. Upon this the court said: "It may be true that to ordinary bankers this way of borrowing money

§ 170. Power of a treasurer to indorse in name of corporation a note for accommodation.— It has been held in one of the courts of New York that a negotiable note indorsed in the name of a manufacturing corporation by its treasurer for the

was unusual or unknown, but to bankers having foreign funds it seems to have been a common mode. To bankers like these plaintiffs there would be nothing unusual or calculated to excite suspicion for any one desiring a loan to apply to them, and for them to make it in such form as was most convenient to them at the time. There is no proof that [the treasurer] suggested the form the loan should take. The inference rather would be that he applied to the plaintiffs, and they suggested the mode adopted. The fact that it was not customary for railroads to borrow money in this way was not sufficient to put the plaintiffs upon their guard, or to excite suspicion of irregularity. The plaintiffs were lenders of foreign money in the Boston market. They were applied to by one who was a customary borrower of home capital from other parties, and whose notes were bought by institutions not only in this state, but out of it. Why should they not loan their funds, under these circumstances, in a manner not unusual with them and bankers of their class? If the defendant had desired to restrict its treasurer to borrowing money from [one certain bank] or through [certain parties] or to the form of borrowing by promissory notes, it could have done so by formal and proper action on the part of the directors. In the absence of any such restriction the defendant must be held liable. When the authority of the agent is left to be inferred by the public from powers usually exercised by the agent, it is enough if the transaction in question involves the same general powers though applied to a new subject-matter. Merchants' Bank *v.* State Bank, 10 Wall. 604. 'It is not necessary in order to constitute a general agent, that he should have done an act the same in specie with that in question. If he has usually done things of the same general character and effect, and with the assent of his principals, that is enough.'" Cowen, J., in Commercial Bank of Erie *v.* Norton, 1 Hill, 501, 503. The right to recover in this case rested mainly on the ground of an implied authority on the part of the treasurer to make this contract, because the corporation held him out to the world as its general fiscal agent authorized to negotiate loans, borrow money, make notes and manage its whole financial business. The court said: "The legal principle relied upon by the plaintiff is well stated in Lester *v.* Webb, 1 Allen, 34: 'The rule is well settled that if a corporation permit the treasurer to act as their general fiscal agent, and hold him out to the public as having the general authority implied from his official name and character, and by their silence and acquiescence suffer him to draw and accept drafts, and to indorse notes payable to the corporation, they are bound by his acts done within the scope of such implied authority.' See, also, Merchants' Bank *v.* State Bank, 10 Wall. 604; Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192." Upon the facts in this particular case the court then considered the questions, whether the directors by their course of conduct, held the treasurer out to the public as the fiscal agent of the corporation, having authority to make and indorse notes for the corporation, and, if so, whether there was anything so unusual in this transaction as to have put the plaintiffs on their inquiry. Colt, J., said: "I have no doubt that the directors by allowing [the treasurer] for several years and for a large amount to sign notes for the corporation, most of which were sold to different banks in the state and some out of it — some of the directors going so far in recognition of [his] authority as to indorse the notes — conferred upon him, so far as the public is concerned, an implied power to borrow money, which the corporation cannot now dispute. As to the nature of this transaction, I am unable to conclude that it was of such an extraordinary character as to relieve the defendant."

[1] Wahlig *v.* Standard Pump Mfg. Co., (N. Y. City Ct. Spl. Term, 1890) 9 N. Y. Supp. 739. "The act of the treasurer" (the corporation receiving no benefit from the note, and the proceeds never reaching its treasury), said McAdam, Ch. J., "under these circumstances, was not a corporate act." Wahlig *v.* Manufacturing Co., (N. Y. City Ct. Gen. T., 1890) 5 N. Y. Supp. 420; Mather *v.* Trust Co., (N. Y. City Ct. Spl. Term, 1890) 7 N. Y. Supp. 213; Westerfield *v.* Radde, 7 Daly 326; s. c., 55 How. Pr. 369. "[This] treasurer had no power to lend the credit of the corporation. If the indorsement was not a corporate act, the fact that the plaintiff was a *bona fide* holder cannot even under Mechanics', etc., Assn. *v.* New York, etc., Lead Co., 35 N. Y. 505, make it a corporate charge. In such a case the remedy would seem to be against the treasurer who acted without corporate sanction, (Green's Brice Ultra Vires, 634) upon the theory that, where the act does not bind the principal, it binds the person who, without authority, assumed to act as agent."

accommodation of the maker could not be enforced against the corporation where the note did not concern any business of the corporation and there was no by-law or resolution authorizing the treasurer to indorse negotiable paper or any proof of a recognized course of business by which the treasurer was held out as possessing such power, or any evidence that the corporation had ratified the act or derived any benefit from it though the note was in the hands of a *bona fide* holder.[1]

§ 171. Power of a treasurer to indorse note of another corporation.— A trading corporation sought in an action to recover of a former treasurer the amount of money it had been compelled to pay on account of an indorsement in its name made upon a note of another corporation, contending that the indorsement was an act *ultra vires* the trading corporation. It appeared that the defendant at the time of indorsing the note in question, and for five years prior thereto, was the treasurer and general manager of the plaintiff. As such general manager he was allowed to exercise his discretion in managing plaintiff's business. During all the years that he was plaintiff's manager the

plaintiff's board of directors left the direction and management of the business to his judgment and habitually held no meetings except an annual meeting. The plaintiff was organized as a corporation under the laws of Connecticut for the purpose of manufacturing and dealing in certain classes of goods, and to exercise such mercantile powers as might be convenient and necessary for the prosecution of its particular business. It had been the practice of the plaintiff to extend financial assistance to parties with whom it had business relations. The whole management of its business was, in fact, intrusted to this treasurer. He made a contract with a carbon manufacturing company upon behalf of his corporation by the terms of which the latter was to receive and sell the greater part of the carbon manufactured by the former company upon certain terms, etc. For the purpose of increasing its manufacture of carbon, the carbon company applied to the treasurer, as representing the trading corporation, for assistance, and made its promissory note for $10,000, payable to the order of the corporation, which note the treasurer in the corporation's name indorsed and procured to be discounted, and handed over the proceeds to the carbon manufacturing company. The Supreme Court held adversely to the claim of the corporation that this note was an accommodation indorsement by its treasurer, and, therefore, *ultra vires*.[1]

[1] Holmes, Booth & Haydens *v.* Willard, (1889) 53 Hun, 629; 5 N. Y. Supp. 610. Van Brunt, P. J., for the court, said: "The transaction as it took place between the carbon company and the defendant, representing the plaintiff, was simply a loan of money. The carbon company gave its note, payable to the order of the plaintiff, and the plaintiff loaned the money upon the note. How it got the money was immaterial, whether by having the note discounted upon its own credit, or otherwise, does not alter the relations of the parties. It was a loan made between the plaintiff and the carbon company, by and through its treasurer, and there is nothing in the case going to show that there was any accommodation indorsement, or anything of that sort. The question raised here, therefore, is whether a loan of money by a corporation is *ultra vires*. We have not been referred to any authority or principle, under which such a transaction can be held *ultra vires* of a corporation, particularly a trading corporation which has the right to exercise such mercantile powers as may be convenient and necessary for the successful transaction of its business, which clearly gives it the authority to extend mercantile facilities to the persons dealing with it if in its judgment it thinks it for the benefit of its business so to do. The transaction, therefore, between the plaintiff and the carbon company was in no respect *ultra vires*. As to the power of the treasurer of the corporation to use its credit and money in such a way, it was said: "It is sufficient to say that the evidence shows conclusively that it had been the practice of this corporation to lend money and extend financial assistance to parties with whom it had business relations. It is true that it is claimed that the only evidence of any such course is that the defendant during his administration often gave financial assistance to customers by him, but that such acts were not reported to the board of directors. But the evidence fails to establish this proposition. It is true that the subsequent treasurer says that such accommodations were not extended to any but the customers by him, but there is no evidence but that it had been the practice prior to this time to give financial assistance to others than customers strictly speaking, in the shape of extending their paper as is claimed to have been only done by [the last treasurer]. And it appears without contradiction that it was not customary for the board of directors to give the manager directions in these matters; that he always exercised the authority, and it was not customary to bring it before the board of directors. In other words, the whole details of the management of the corporation were, as above stated, committed to the general manager. Under this state of things, it is difficult to see how the defendant can be held liable, because of his action, in conducting the business in precisely the same way in which it had heretofore been done, and extending aid to persons with whom the plaintiff had dealings. If corporations choose to place the whole of the management of their business for the purpose of expedition in the hands of a single individual, and give him a general authority to act as under the circumstances may seem best to him, unless absolute fraud is shown on his part, there seems to be no ground upon which a right of recovery can be had against him for any such acts. Certainly a mere mistake in judgment does not render him liable. Trading corporations are necessarily managed in a more informal way than those of a different character. They are voluntary copartnerships, having a right of survivorship, not dissolved by reason of the death of any one of the parties in interest, and a director or officer or manager, with whom is intrusted all the business of the corporation, can exercise all the powers which the board of directors could exercise under the same circumstances in the general management of the corporation business. Hoyt *v.* Thompson, 19 N. Y. 209. Even if we concede that the corporation had no power to lend its money, yet, when it is found that it had been in the habit of so doing, and that it had been the course of business of the corporation, certainly an officer cannot be held liable simply because he has continued the practice."

§ 172. When a corporation will be bound by a note executed by its treasurer.—In a case where a bank discounted a note for a private corporation "in the usual course of its business without notice of any defect or infirmity," and its good faith was not questioned, the Supreme Court of Massachusetts held that if the note was signed by an officer authorized generally to give notes in its behalf the corporation would be liable, although the agent in signing this particular note exceeded his authority or the powers of the corporation.[1]

[1] Merchants' Nat. Bank of Gardiner *v.* Citizens' Gas Light Co. of Quincy, (1893) 159 Mass. 505; s. c., 34 N. E.

§ 173. When a corporation is bound by acts of treasurer. — In a recent case before it the Supreme Court of New York, in General Term, has held that where the treasurer of a business corporation was also permitted to become and act as its sole financial manager, the corporation would be chargeable, irrespective of the question of authority, in fact, with liability for acts done by him within the apparent scope of the authority conferred upon him by the corporation. In this case, for instance, the treasurer of a water works company had been permitted, through the omission of its other officers to direct its financial management or supervise his acts, to become and act as its sole financial manager, and had made and negotiated some fifty promissory notes in its name during a period extending over about a year and a half. The court held that the company was liable to a *bona fide* holder for value of a promissory note executed in its name by such treasurer, which matured while he was still treasurer, and the proceeds of which, so far as received by him, had been applied to the use of the corporation, although the note was not specially authorized.[1]

Rep. 1083, citing Monument Nat. Bank *v.* Globe Works, 101 Mass. 57. BARKER, J., for the majority of the court, said, *arguendo:* "It is not necessary that the authority of an officer or agent to sign notes in behalf of a corporation should appear in the by-laws, or should have been expressly given by a vote of the directors or of the stockholders. In Lester *v.* Webb, 1 Allen, 34, it was said: 'The rule is well settled that if a corporation permit their treasurer to act as their general fiscal agent and hold him out to the public as having the general authority implied from his official name and character, and by their silence and acquiescence suffer him to draw and accept drafts and to indorse notes payable to the corporation, they are bound by his acts done within the scope of such implied authority. Fay *v.* Noble, 12 Cush. 1; Williams *v.* Cheney, 3 Gray, 215; Conver *v.* Insurance Co., 1 N. Y. 290. On the facts found at the trial the plaintiff might well claim, if the jury believed the evidence, that the treasurer had authority to indorse the notes in suit, derived, not from any express direction, but from the course of conduct and dealing of the treasurer with the knowledge and implied assent of the directors of the corporation.'" See, also, McNeil *v.* Chamber of Commerce, 154 Mass. 285; s. c., 28 N. E. Rep. 245; Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192. "But," said the Massachusetts court, "cases where the actual authority of an officer is inferred from a course of business known to and permitted by the stockholders or directors of a corporation, do not touch the question whether authority is to be implied as matter of law from the name and nature of the office itself. In the present case the jury were instructed that the treasurer of such a corporation as the defendant company has, by virtue of his office, authority to sign a note which shall bind the corporation, and the defendant contends that this instruction was incorrect. The incidental powers of some officers or agents have become so well known and defined, and have been so frequently recognized by courts of justice, that certain powers are implied as matters of law in favor of third persons who deal with them on the assumption that they possess these powers, unless such persons are informed to the contrary. The officers and agents usually mentioned in this category are auctioneers, brokers, factors, cashiers of banks and masters of ships. See Merchants' Bank *v.* State Bank, 10 Wall. 604; Case *v.* Bank, 100 U. S. 446. Treasurers of towns or cities in this commonwealth are well-known officers, and their powers are very limited. They are in general to receive, keep and pay out money on the warrant of the proper officers of the towns and cities. Treasurers of business corporations usually have much more extensive powers, and the decisions of this court hold that the treasurer of a manufacturing and trading corporation is clothed, by virtue of his office, with power to act for the corporation in making, accepting, indorsing, issuing and negotiating promissory notes and bills of exchange, and that such negotiable paper in the hands of an innocent holder for value, who has taken it without notice of any want of authority on the part of the treasurer, is binding on the corporation, although with reference to the corporation it is accommodation paper. Narragansett Bank *v.* Atlantic Silk Co., 3 Met. 282; Bates *v.* Iron Co., 7 Met. 224; Fay *v.* Noble, 12 Cush. 1; Lester *v.* Webb, 1 Allen, 34; Bank *v.* Winchester, 8 Allen, 109; Bird *v.* Daggett, 97 Mass. 494; Monument Nat. Bank *v.* Globe Works, 101 Mass. 57; Corcoran *v.* Cattle Co., 151 Mass 74; s. c., 23 N. E. Rep. 727. While it is possible that most, if not all, of the cases in which this rule has been stated as law have some special circumstances from which the treasurer's authority could be inferred, and that the court was influenced in the decisions by the well-known fact that in many of the manufacturing corporations of this commonwealth the treasurer not only has the custody of the money, but is the general financial manager, and often the general business manager of the corporation, the rule itself has been frequently and broadly stated in our decisions and is well known both to the officers of manufacturing and trading corporations and to those of banks and financial institutions. It could not now be abrogated or unsettled without disturbing commercial transactions. There are, however, many corporations which transact more or less business to which the rule has been held not to apply. Thus, it does not apply to a college (Webber *v.* College, 23 Pick. 302); nor to a parish (Packard *v.* Society, 10 Met. 427); nor to a monument association (Torrey *v.* Dustin Monument Association, 5 Allen, 327); nor to a municipality (Bank *v.* Winchester, 8 Allen, 109); nor to a savings bank (Tappan *v.* Bank, 127 Mass. 107); nor to a horse railroad company (Craft *v.* Railroad Co., 150 Mass. 207; s. c., 22 N. E. Rep. 920)."

[1] Perry *v.* Council Bluffs Water Works Co., (1893) 67 Hun, 456; s. c., 22 N. Y. Supp. 151. The court approved the findings and the reasoning and conclusions of the referee in this case, O'BRIEN, J., speaking for the court, referring to them thus: "He finds that during the period from some time in the month of October, 1885, to February 27, 1887, Harry Allen, as treasurer of the defendant corporation, made and issued in the name of the defendant, and to which the name of the defendant was signed by himself as treasurer thereof, some forty or fifty promissory notes, to the order of and

§ 174. When a corporation will not be bound by the act of its treasurer.— In a case before the Supreme Court of New York the corporation provided for all its obligations by the issue of bonds. Parties, among whom was its treasurer, became possessed of these bonds by agreeing to pay the debts of the company. To discharge the personal liability thus incurred, the treasurer discounted notes of the company made by him without

indorsed 'Allen & Stead,' which were negotiated and money obtained thereon; that the reason for the making of such promissory notes to the order of Allen & Stead was that they were acting as the financial agents of the defendant, and it was to give additional credit to such notes, the credit of the corporation itself being poor, and, although the by-laws of the defendant required the countersigning by the president, none of these notes so issued was so countersigned; that the note in suit was, in form, similar to these others; that during all this period, with the exception of one in May, 1886, no meetings of the board of directors were held, and at the one meeting no business was transacted other than the re-election of officers of the defendant; that Allen, though he sought to consult and advise with the president of the corporation, was referred to the latter's law partner, who was also a director in the corporation; that none of the officers or directors used or exercised any official supervision over Allen or his acts and transactions as treasurer, except the director who was the president's law partner, and who, it would appear, was not only consulted with respect to the making of the promissory notes, and the obtaining of money thereon, but concurred in the very beginning with the making of such promissory notes; that further, he not only advised the making and issuing of such notes from time to time, but personally indorsed a large number of them, and one with the name of his firm, of which the president was a member. A review of the evidence supporting these findings will sustain the referee and justify his conclusion that Allen was practically the corporation, and that the case is brought within the principle laid down in Fifth National Bank *v.* Navassa Phosphate Company, 119 N. Y. 256, because he was not only the treasurer of the defendant, but, as said in that case, 'he was consciously invested by the company with the broad general power inseparable from the position in which it placed him as the sole manager of its affairs at its principal place of business.' Acting, therefore, within the apparent scope of the authority conferred upon him by the corporation, the latter is charged with liability, irrespective of the question of authority in fact." This particular note had been placed as collateral security with a certain party who loaned a certain amount upon it, under an agreement that it was to be paid within a few days, with interest, at the rate of five dollars a day until such time as the loan was paid. The court limited the measure of damages in the recovery to the amount loaned by this person, with legal interest from the date of his loan. It was said in the opinion: "Taking the facts here, we think that this note was not valid as a legal obligation in the hands of the payee negotiating it, or in the hands of Bradford, who delivered it to the plaintiff as collateral security for a loan made by him. but that when transferred to the plaintiff it became in his hands a legal obligation against the defendant, but only to the extent of what was advanced upon the faith thereof. We think the principle of the cases, which, under such circumstances, would prevent a profit being made out of the transaction, is applicable, and that, while the plaintiff is entitled to protection to the extent of the moneys advanced, and legal interest from the date of the loan, he cannot recover either the face value of the note, with interest thereon, nor the amount loaned, with interest at the rate agreed upon by Bradford, of five dollars a day."

[1] First Nat. Bank of Middletown *v.* Council Bluffs City Water Works Co., (1890) 56 Hun, 412; s. c., 9 N. Y. Supp. 859. In support of their contention the counsel of the bank cited Bank of Batavia *v.* New York, L. E. & W. R. R. Co., 106 N. Y. 195; s. c., 12 N. E. Rep. 433, and Bank of Auburn *v.* Putnam, 1 Abb. Dec. 80. PRATT, J., upon the question whether the facts of the case brought it within the rules of the cases cited, said: "There was no evidence that any part of the proceeds of the notes sued on came to the use of the company. The bonds and money which [the treasurer] received for these notes be retained. As to the bonds, the evidence was that he still had them. As to the money, it went into his individual bank account, and he refused to say that he paid any debt of the company out of that bank account after he received the money. He would not even say that he kept the money for the payment of what the company owed him, although he tried to produce that impression. There was no evidence, however, that the company owed him anything, except his general stateemnt that they owed him something, but what the something was he did not attempt to say. Of course, as treasurer of the company, he could not issue its notes and sell them, and pocket the proceeds, under the pretense that the company owed him money, without showing some authority outside of himself for such a transaction, and without establishing, in the most satisfactory manner, that the company was indebted to him for the amount which he so obtained. The referee found that the proceeds of some of the previous notes made by [the treasurer] were applied 'to at least some extent,' to the payment of the debts and obligations of the defendant. This fact would tend to establish the company's liability for the notes sued on, under the theory that they were responsible in thus having its authority or knowledge, or that of its officers. It was sought to hold the corporation liable in an action by the bank which discounted them upon the ground that the treasurer was a financial officer of the corporation, and, therefore, held apparent authority to indorse the notes, so far as *bona fide* purchasers were concerned, and upon another ground that the previous conduct of the treasurer had been such in issuing the notes that the corporation must be held to have authorized the making and indorsement of the notes in suit. It was held by the court that the treasurer of a corporation engaged in the business of operating water works did not have, by virtue of his office, any implied authority to borrow money and give the corporation's note therefor.[1]

§ 175. Another illustration of such a case.— In a Massachusetts case it appeared that a stockholder, who was the treasurer of a street railway corporation, wrote to a customer that he could lend the proceeds of bonds sold by him for her to the corporation, and she told him that she would so lend a part of the proceeds to it, and left the amount in his hands, receiving from him a note for the amount made in the corporation's name by him alone as treasurer. She was ignorant of and made no inquiries as to the by-laws of the corporation, which provided that he could sign notes only as the directors might require, which notes, to bind the corporation, were to be countersigned by the president, but acted in good faith, believing that the treasurer of the corporation also acted honestly and had authority to make the loan and to give a note for the same binding upon the corporation. The treasurer had no such authority in terms, and, being a defaulter, used the loan to cover up his defalcation by paying debts of the corporation. The Supreme Court of Judicature held that his customer in the stock brokerage business could not recover against the corporation either upon the note or for money had and received.[1]

§ 176. When contracts of a chief engineer will bind a railroad corporation.— It appeared in a Michigan case that certain individuals organized a railroad corporation for the purpose of constructing a line of railroad. Two of these individuals entered into an agreement, by which the third interested party was to construct the road, to be paid in bonds and stock. This latter was the principal promoter of this railroad enterprise. The work was to be done under the supervision of a chief engineer. The work for building the road was let to a sub-contractor. The plaintiff in this action had furnished supplies for this work to the sub-contractor. Failing to be paid, this action against the company resulted. In it the plaintiff claimed that the goods were delivered upon orders given by the company's agent, and upon its credit. The principal question in the case arose upon the authority of the agent to bind the company. The Supreme Court of Michigan held that the question of the authority of the agent was one of fact properly submitted to the jury, and reviewed the evidence and affirmed the judgment against the company. They said of the testimony: "[It] brings the case within any one of several well-established rules. If the company relinquished to [this contractor] the matter of construction of this road, and [he] knew that [its chief engineer] was contracting these obligations in the name and upon the credit of the company, [the contractor] must be deemed to have adopted them. His knowledge was the company's knowledge, and the company is liable. If the officers of the company were advised that [the chief engineer] had incurred the indebtedness to plaintiff in the name and upon the credit of the company, and with that knowledge did not protest, but, on the contrary, corresponded directly with the plaintiffs and paid that account, plaintiffs were justified

held out [the treasurer] as their agent to make their notes. But in order to create such an agency by representation or estoppel, it is essential that the principal shall have knowledge of the assumption by the agent of the powers he has exercised. In order to create a liability in this case, therefore, it was necessary to go a step further in the findings, and to find that the company had knowledge of the fact that [the treasurer] had so applied the proceeds of these notes. There not only is no such finding, but the referee has expressly found that the directors had no knowledge that [he] had assumed to make the notes of the company, and that they never authorized him to do so. The finding with regard to the application of the proceeds of the notes, therefore, does not go for enough to establish a liability in this case. The fact that an agent has, in one or more instances, made notes and applied the proceeds in part payment of his principal's debts, without his knowledge, creates no liability on his part for his subsequently making notes in the name of the principal."

[1] Craft *v.* South Boston Railroad Co., (1889) 150 Mass. 207; s. c., 22 N. E. Rep. 920. Upon the first point it was said: "Whatever may be true of trading corporations there is nothing in the nature of the business of a horse railroad corporation, or of the duties of a treasurer of such a corporation, which implies that the treasurer, by virtue of his office, has authority to borrow money for the company and to give its notes therefor. It does not appear that the company in any way held out [their treasurer] to the public or to the plaintiff as having any such authority, or that treasurers of horse railroad corporations customarily have or exercise any such authority." Upon the second it was said: "No objection on the part of the [corporation] ought to be implied in this case, because [its treasurer] was a defaulter, and the money was used to cover up his defalcation by paying debts of the company, which the money of the company, if he had not embezzled it, would have been used to pay. The only reasonable inference is that [the treasurer's] primary purpose in using the money in this way was to escape detection and to benefit himself. Whether it was a benefit to the company that he was able to obtain and use money for this purpose is necessarily uncertain. The money was not borrowed *bona fide* for the use of the company. See Railroad National Bank *v.* Lowell, 109 Mass. 214; Agawam National Bank *v.* South Hadley, 128 Mass. 503."

in relying upon that action as an assurance of [the chief engineer's] authority, and extending further credit, and defendant is estopped from the denying the authority of [its chief engineer]. If [the latter], in the exercise of the authority given to him by the contract, in view of [the sub-contractor's] inability, was prosecuting the work for and on behalf of the company, and incurred this indebtedness in such prosecution of the work, the plaintiffs were entitled to recover. If [the chief engineer] was entering into contracts for the work upon the road, employing men and purchasing supplies in the name of the company and upon its credit, and the officers of the company knew of the fact, or had been advised of instances of like conduct and remained silent, the company cannot now be heard to say that such person so acting was without authority."[1] In another action against this railroad company for supplies furnished to the sub-contractor in the construction of its road, the same court held that upon the evidence the principles of the last case were established, and that the railroad company was properly found liable, not only upon the verbal arrangement made by the chief engineer with the plaintiff through its managing officer, but also upon a written guaranty of the sub-contractor's orders for supplies made by the engineer.[2] They further held in this case that the third of the then parties organizing this railroad company, with whom the two entered into the agreement for the construction of the railroad, who was its president, could bind the corporation for supplies used in the construction, though not acting by any corporate authority. This president was at the same time president of the supply company which brought this action. It was contended that from this fact, and his powers being limited in the contract with his associates for the construction of the road, which provided that "no indebtedness shall be incurred and no expenditures made without the free consent and co-operation of all the parties to the agreement," his knowledge of this limitation was the knowledge of the plaintiff, and, therefore, the

[1] Hirschmann *v.* Iron Range & Huron Bay R. R. Co., (1893) 97 Mich. 384; s. c., 56 N. W. Rep. 842. The court referred in its discussion to the following cases as in point: Olcott *v.* Railroad Co., 27 N. Y. 546, 558; Ceeder *v.* H. M. Loud & Sons Lumber Co., 86 Mich. 541; Whitaker *v.* Kilroy, 70 Mich. 635, 638; Beattie *v.* Railroad Co., 90 N. Y. 643.

[2] Michigan Slate Co. *v.* Iron Range & Huron Bay R. R. Co., (1894) 101 Mich. 14; s. c., 59 N. W. Rep. 646.

latter was estopped from the recovery. The court held adversely to this contention.[1]

§ 177. Ratification by corporation of agent's acts — general rules.— If a trading corporation take and hold the benefit derived from a contract made for it by an agent not duly authorized, it thereby makes the contract its own by ratification or adoption and will thereby be estopped from disputing its liability thereon.[2] A corporation will be held liable for materials furnished for its use and benefit by the order of one not expressly authorized to give such order, where its officers have knowledge of the order and do not object to it.[3] Ratification of an unauthorized act of an agent of a corporation will be inferred from failure on the part of the corporation to promptly disavow it upon knowledge of the act being brought to it.[4] The ratification of an unauthorized act of an agent of a corporation is equivalent to a previous authority, and such ratification need not be by any formal vote or resolution of the corporation, or be authenticated by the corporate seal.[5] A ratification of an act of an officer of a corporation in making a contract may be implied by the acts of the corporation as well as expressed by its vote. The acts and assent of corporations may be shown and inferred from facts and circumstances.[6] Before a corporation can be said to have ratified

[1] Ibid. The court said: "A party may act in the double relation of agent for both parties." Adams Mining Co. *v.* Senter, 26 Mich. 73; Colwell *v.* Keystone Iron Co., 36 Mich. 51; U. S. Rolling Stock Co. *v.* Atlantic & G. W. R. Co., 34 Ohio St. 450; Mayor, etc., *v.* Inman, 57 Ga. 370; Manufacturers' Sav. Bank *v.* Big Muddy Iron Co., 97 Mo. 38; s. c., 10 S. W. Rep. 865; Kitchen *v.* Railway Co., 69 Mo. 224; Fitzsimmons *v.* Express Co., 40 Ga. 330. See, as to contract made by one styled engineer of the railroad corporation, Wilson *v.* Kings County Elevated R. R. Co., (1889) 114 N. Y. 487.

[2] Pixley *v.* Western Pacific R. R. Co., (1867) 33 Cal. 183; Gas Company *v.* San Francisco, 9 Cal. 453; Argenti *v.* San Francisco, 16 Cal. 265; Fraylor *v.* Sonora Mining Co., 17 Cal. 594; Rosborough *v.* Shasta River Canal Co., 22 Cal. 556; Allen *v.* Citizens' Steam Navigation Co., 22 Cal. 28; United States *v.* Dandridge, 12 Wheat. 70; Olcott *v.* Tioga R. R. Co., 27 N. Y. 558; Hoyt *v.* Thompson, 19 N. Y. 215; Bank of Kentucky *v.* Schuylkill Bank, 1 Parsons' Sel. Cas. in Equity, 250.

[3] Beattie *v.* Delaware, Lack. & West. R. R. Co., (1881) 12 N. Y. Wkly. Dig. 334.

[4] First National Bank *v.* Fricke, (1881) 75 Mo. 178.

[5] Campbell *v.* Pope, (1888) 96 Mo. 468; s. c., 10 S. W. Rep. 187.

[6] Louisville, New Albany & Chicago Ry. Co. *v.* Carson, (1894) 151 Ill. 444;

an unauthorized contract of its agent by receiving the consideration of the contract, there must be proof that the corporation, through its proper officer, knew the terms of the contract and received the money on that account.[1] A contract having been made by an agent of a corporation out of the usual course of business of the corporation, and his receiving money as a consideration of the contract and paying it to the corporation, the retention of the money by the latter will not constitute an adoption of the contract, unless it appears that the corporation knew on what account the money was paid and what were the terms of the contract.[2]

Farmers & Citizens' Bank *v.* Sherman, 6 Bosw. 181; Hoyt *v.* Shelden, 3 Bosw. 267; Houghton *v.* Dodge, 5 Bosw. 326; Madison Avenue Baptist Church *v.* Baptist Church in Oliver St., 2 Abb. Pr. (N. S.) 254; s. c., 32 How. Pr. 335. What amounts to a ratification of the contracts of officers or agents. Marine Bank *v.* Butler Colliery Co., 52 Hun, 612; s. c., 5 N. Y. Supp. 291; Mobile & M. Ry. Co. *v.* Gilmer, 85 Ala. 422; s. c., 5 So. Rep. 138; Campbell *v.* Pope, 96 Mo. 468; s. c., 10 S. W. Rep. 187; Hamilton *v.* Bates, (Cal. 1894) 35 Pac. Rep. 304 (holding there was no ratification of an agreement of the president that the corporation should assume the debts of a person); Frank *v.* Hicks, (Wyo. 1894) 35 Pac. Rep. 475; Bibb *v.* Hall, (Ala. 1894) 14 So. Rep. 98; Nebraska & K. Farm Loan Co. *v.* Bell, 58 Fed. Rep. 326; s. c., 7 C. C. A. 253; West Salem Land Co. *v.* Land Co., 89 Va. 192.

[1] Hyde *v.* Larkin, (1889) 35 Mo. App. 365. As to corporations receiving the benefit of a contract made by its agents or officers being considered as ratifying it, see Jourdan *v.* Long Island R. R. Co., 115 N. Y. 380; s. c., 22 N. E. Rep. 153; Scott *v.* W., etc., R. R. Co., 86 N. Y. 200; Wild *v.* New York, etc., M. Co., 59 N. Y. 644; Decker *v.* G., etc., Co., 61 Hun, 516; Hoag *v.* Lamont, 60 N. Y. 96; Bommer *v.* S. S. Co., 81 N. Y. 468; Castle *v.* Lewis, (1879) 78 N. Y. 131, affirming 13 Hun, 298; Kickland *v.* Menasha Wooden Ware Co., 68 Wis. 34; Paxton Cattle Co. *v.* First Nat. Bank, 21 Neb. 621; Holmes *v.* Kansas City Board of Trade, 81 Mo. 137; Pauling *v.* London Ry. Co., 8 Exch. 867; Beverley *v.* Lincoln Gas Co., 6 Ad. & El. 829; Tuskaloosa, etc., Co. *v.* Perry, 85 Ala. 158; Melledge *v.* Boston Iron Co., 5 Cush. 158, 175; Smith *v.* Martin Anti-Fire Car Heater Co., 64 Hun, 639; s. c., 19 N. Y. Supp. 285; Brower *v.* Brooklyn Trust Co., 21 N. Y. Supp. 324; Tryon *v.* White & Corbin Co., 62 Conn. 161; s. c., 25 Atl. Rep. 712; Weatherford, M. W. & N. W. R. Co. *v.* Granger, (Tex. Civ. App. 1894) 22 S. W. Rep. 70.

[2] Pennsylvania, Del. & Maryland Steam Navigation Co. *v.* Dandridge, 8 G. & J. (Md.) 248. As to estoppel to deny authority of officers and ratification of their acts on the part of a corporation, see Tuskaloosa Cotton Seed Oil Co. *v.* Perry, 85 Ala. 158; s. c., 4 So. Rep. 635; Morrell *v.* Long Island R. Co., (N. Y. City Ct. Spl. T.) 1 N. Y. Supp. 65; Fitch *v.* Lewiston Steam Mill Co., 80 Me. 34; s. c., 12 Atl. Rep. 732; Metropolitan T. & T. Co. *v.* Domestic T. & T. Co., 44 N. J. Eq. 568; s. c., 14 Atl. Rep. 907; Alabama Great So. R. R. Co. *v.* South & North Alabama R. R. Co., 84 Ala. 570; s. c., 3 So. Rep. 286; Hoosac Mining & Milling Co. *v.* Donat, 10 Col. 529; s. c., 16 Pac. Rep. 157; Second Nat. Bank *v.* Pottier & Stymus Mfg. Co., 56 N. Y. Super. Ct. 216; s. c., 2 N. Y. Supp. 644; Getty *v.* C. R. Barnes Milling Co., 40 Kans. 281; s. c., 19 Pac. Rep. 617; Corn Exchange Bank *v.* American Dock & Trust Co., 78 Hun, 400; s. c., 29 N. Y. Supp. 158; Thomas *v.* City Nat. Bank, (Neb. 1894) 58 N. W. Rep. 943; Moyer *v.* East Shore Terminal Co., (1893) 41 S. C. 300; s. c., 19 S. E. Rep. 651; Norton *v.* Alabama National Bank, (Ala. 1894) 14 So. Rep. 872; Martin *v.* Santa Cruz Water Storage Co., (Ariz. 1894) 36 Pac. Rep. 36 (where there was held to have not been a ratification); Currie *v.* Bowman, (1894) 25 Or. 364; s. c., 35 Pac. Rep. 848 (ratification of execution of a mortgage); Church *v.* Sterling, 16 Conn. 398; Howe *v.* Keeler, 27 Conn. 554; Johnson *v.* Smith, 21 Conn. 632; Hewitt *v.* Wheeler, 22 Conn. 564; Hyde *v.* Larkin, 35 Mo. App. 365; Union Bridge Co. *v.* Troy & Lansingburgh R. R. Co., (1872) 7 Lans. 240. What does not: Harrington *v.* First Nat. Bank of Chittenango, (1873) 1 T. & C. 361. In Liebfritz *v.* Dubuque Street Railway Co., (1878) 48 Iowa, 709, the managing director of a corporation having knowledge that an agent of the company had borrowed money and applied it to the payment of corporate indebtedness, the corporation was held liable for the sum borrowed.

§ 178. Modes of ratification.— The United States Circuit Court of Appeals for the eighth circuit held that the board of directors of this corporation upon the promissory note of which this action was brought by the receiver of the bank which loaned the corporation money on the note, who were authorized by its by-laws to borrow money and execute securities therefor, might ratify the unauthorized execution of the promissory note by the secretary of the corporation, and thus the corporation would be bound.[1] In a case where the foreman of a mining corporation, with the knowledge and acquiescence of the officers of the corporation — but without any special request — advanced money to pay the debts of the corporation, and the corporation, with full knowledge of all the facts, acquiesced in the acts of its officers and agents in their dealings with the foreman, the Supreme Court of Nevada held that such knowledge and acquiescence amounted to a ratification of the acts of the foreman and rendered the corporation liable to him for the money so advanced.[2]

[1] Nebraska & Kansas Farm Loan Co. *v.* Bell, (1893) 58 Fed. Rep. 326; citing Allis *v.* Jones, 45 Fed. Rep. 148; Indianapolis Rolling Mill Co. *v.* St. Louis, Ft. S. & W. Ry. Co., 120 U. S. 256; s. c., 7 Sup. Ct. Rep. 542; Pittsburgh, C. & St. L. Ry. Co. *v.* Keokuk & H. Bridge Co., 131 U. S. 378; s. c., 9 Sup. Ct. Rep. 770.

[2] Martin *v.* Victor Mill & Mining Co., (1885) 19 Nev. 180; s. c., 8 Pac. Rep. 161. A ratification of an agent's use of the corporation's funds for "special purposes" by a resolution of the directors, held not to be void, as constituting a fraud upon the stock-

§ 179. Illustration of ratification of contract of agent.— In a late California case it appeared that a corporation, by resolution of its directors, authorized its president to execute a mortgage to secure a loan at a rate of interest and for a length of time specified. The mortgage executed by him was for a shorter period than authorized, and provided that the interest should be paid monthly; that a failure to pay interest when due rendered the principal due and that the mortgagees should recover attorney's fees in case of foreclosure. In an action to foreclose this mortgage the assignee of the corporation appointed after the suit was begun, being made a party, defended upon the ground *inter alia* that the execution of the mortgage on terms which were a departure from the terms named in the resolution of the directors was in excess of the authority of the president and not binding upon the corporation. The facts that the president of the corporation included in the note and mortgage terms and conditions which the corporation had power to authorize, but which it did not authorize him to insert; that the corporation received the consideration of $17,000 from the plaintiffs and applied the money to its uses, including the payment of a prior mortgage upon its property and the extinguishment of the lien thereof; that the

holders. Clark *v.* American Coal Co., (1892) 86 Iowa, 436. As to contracts being made valid by ratification by a corporation, see Dubuque College *v.* Dubuque, 13 Iowa, 555–560; Beach on Priv. Corp. § 195; Oregon Ry. *v.* Oregon Ry. & Nav. Co., 28 Fed. Rep. 505; Greenleaf *v.* Norfolk Southern Ry., 91 N. C. 33; First Nat. Bank *v.* Fricke, 75 Mo. 178; Kelsey *v.* National Bank, 69 Pa. St. 426; Eureka Co. *v.* Bailey Co., 11 Wall. 488, 491; Gold Mining Co. *v.* National Bank, 96 U. S. 640, 644; Pacific Rolling Mill Co. *v.* Dayton Ry., 7 Sawy. 61, 67; Walworth Co. Bank *v.* Farmers' Loan & Trust Co., 16 Wis. 629; Connett *v.* City of Chicago, 114 Ill. 233; Wood *v.* Whelen, 93 Ill. 153. Ratification generally: Nims *v.* Mt. Hermon Boys' School, 160 Mass. 177; s. c., 35 N. E. Rep. 776; People *v.* Eel River & E. R. Co., 98 Cal. 665; s. c., 33 Pac. Rep. 728; Willis *v.* St. Paul Sanitation Co., (1893) 53 Minn. 370; s. c., 55 N. W. Rep. 550; Augusta, T. & G. R. Co. *v.* Kittel, 52 Fed. Rep. 63; s. c., 2 C. C. A. 615; 2 U. S. App. 409; Hitchings *v.* St. Louis, N. O. & O. Canal & Transp. Co., 68 Hun, 33; s. c., 22 N. Y. Supp. 719; Tingley *v.* Bellingham Bay Boom Co., 5 Wash. St. 644; s. c., 32 Pac. Rep. 737; Goldbeck *v.* Bank, 147 Pa. St. 267; Haines *v.* Detrick, 75 Md. 256; Smith *v.* Martin Anti-Fire Car Heater Co., 64 Hun, 639; s. c., 19 N. Y. Supp. 285; Seymour *v.* Association, 64 Hun, 632; McComb *v.* Association, 134 N. Y. 598; Shaver *v.* Hardin, 82 Iowa, 378; Hayden *v.* Wheeler & Tappan Co., 66 Hun, 629; s. c., 20 N. Y. Supp. 902; Seal *v.* Puget Sound Loan & Invest. Co., 5 Wash. St. 422; s. c., 32 Pac. Rep. 214.

corporation, by its representations, declarations and acts, through its directors, intentionally led the plaintiffs to believe, and they did believe, the president of the corporation was authorized to execute the note and mortgage for one year, with interest payable monthly; that the corporation, with full knowledge of the terms and conditions of the note and mortgage, received and used the consideration of $17,000, and paid the interest thereon monthly as the same became due for about four months, were held sufficient to constitute a ratification of the acts of the president of the corporation and sufficient to support the invocation of an estoppel in pais.[1]

§ 180. What does not amount to a ratification.— A treasurer of a Massachusetts savings institution for the corporation became a party to an assignment for the benefit of creditors, and thereby undertook to release one of the promisors on a joint and several note belonging to the institution. The by-laws of the corporation, concerning the duties of the treasurer or as *ex officio* secretary, after enumerating several particulars, provided generally that "he shall perform and discharge all such other duties, in addition to the above, as are usually required of the treasurer and secretary of similar institutions." There was no record of any vote of the institution to release any claim against any person, or to cancel, or discharge, or receive payment, partial or in full, of any debt of any person whatever. The binding effect of this action of the treasurer upon the corporation being for the consideration of the Supreme Court, it was held that the treasurer of an incorporated institution for savings had no authority, as such, and without being specially authorized thereunto, to execute a release in the name of the corporation. Further, they held that the facts that payments of dividends were subsequently made to the treasurer's successor in office, and indorsed on the note of the one making the assignment, and entered in the books of the institution, as so much received of the assignees of the promisor, and the treasurer's account and cash, including the sum so received, and the notes of the institution, including the note in question, were subsequently examined by a committee and certified as correct, were not acts which amounted to a ratifi-

[1] Gribble *v.* Columbus Brewing Co., (1893) 100 Cal. 67; s. c., 34 Pac. Rep. 527.

cation of the release.[1] It appeared, in an action upon a written contract executed in the name of a corporation by its president, that there was no vote, either of the corporation or of the directors, giving the president authority to execute the contract; that under the by-laws, the directors might confer upon him such authority; that there were five directors, of whom the president was one, and there was evidence that one director, besides the president, knew of this contract, but there was no direct evidence that the other three directors had any knowledge of it. The jury were instructed that if "the corporation, represented by its entire board of officers, knew of and ratified the contract, it would be as binding as if the corporation had authorized it by express vote," with this *addendum:* "But all directors of a corporation are presumed to know what it is their duty to know, what they are able to know, and what they undertook to know when they accepted the responsibility of directors, and a jury have a right to suppose that the directors of a corporation have a knowledge of its concerns. In the absence of direct and positive evidence of the knowledge of the directors, jurors have a right to assume that they are doing what they were appointed to do, and that they know what they are appointed to know." The Supreme Court of Massachusetts held such instruction to be erroneous.[2]

[1] Dedham Institution for Savings *v.* Slack, (1850) 6 Cush. 408.

[2] Murray *v.* Nelson Lumber Company, (1887) 143 Mass. 250; s. c., 9 N. E. Rep. 634. MORTON, Ch. J., speaking for the court, said: "It is a well-settled rule that a ratification by a principal of the unauthorized acts of an agent, in order to be effectual, must be made with a knowledge on the part of the principal of all the material facts. And the burden is upon the party who relies upon a ratification to prove that the principal, having such knowledge, acquiesced in and adopted the acts of the agent. It is not enough for him to show that the principal might have known the facts by the use of diligence. Combs *v.* Scott, 12 Allen, 493. Where the alleged principal is a corporation, a ratification may be shown by proving that the officers who had the power to authorize the act knew of it, and adopted it as a valid act of the corporation, although no formal vote is passed by them. Sherman *v.* Fitch, 98 Mass. 59; Lyndeborough Glass Co. *v.* Massachusetts Glass Co., 111 Mass. 315; Kelley *v.* Newburyport Horse Railroad, 141 Mass. 496. In the case at bar, therefore, it was incumbent upon the plaintiff to show that the directors, or at least a majority of them, knew of the contract and its terms, and that, with such knowledge, they acquiesced in and adopted it. But the instructions given by the court gave to the jury a different test. Under them, the jury would naturally understand that it was not necessary to find that the directors knew of the contract, and that it would be sufficient if, in their judgment, the directors, by the use of diligence, might have known it. The instructions are even broader than this, as they told the jury that the directors were presumed to know what they were able to know, and that the jury had the right to suppose that the directors of a corporation had a knowledge of its concerns." Knowledge of officer imputable to the corporation. Anderson *v.* Kinley, (Iowa, 1894) 58 N. W. Rep. 909; Merchants' Nat. Bank *v.* Tracy, 77 Hun, 443; s. c., 29 N. Y. Supp. 77; Huron Printing & Bindery Co. *v.* Kittleson, (S. D. 1894) 57 N. W. Rep. 233; Willard *v.* Denise, 50 N. J. Eq. 482. Estoppel of corporation to deny authority of its officers and agents. Dallas *v.* Columbia Iron & Steel Co., 158 Pa. St. 446; s. c., 27 Atl. Rep. 1055; St. Louis & S. F. R. Co. *v.* Kirkpatrick, 52 Kans. 104; s. c., 34 Pac. Rep. 400; Duggan *v.* Pacific Boom Co., 6 Wash. 593; s. c., 34 Pac. Rep. 157; Merchants' Nat. Bank *v.* Citizens' Gaslight Co., 159 Mass. 505; s. c., 34 N. E. Rep. 1083; Jourdan *v.* Long Island R. Co., 115 N. Y. 380; s. c., 22 N. E. Rep. 153; Beach *v.* Miller, 130 Ill. 162; s. c., 22 N. E. Rep. 464; Brown *v.* Wright, 25 Mo. App. 54.

CHAPTER V.

FRAUDULENT ACTS OF OFFICERS.

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§ 181. General rules.— Directors of a corporation will be held responsible to the stockholders for losses from fraud, embezzlement, willful misconduct, breach of trust and for gross inattention or negligence, as a result of which fraud has been perpetrated by agents, officers or co-directors.[1] It is now well settled that directors and managers of corporations are equally within the rule which guards and restrains the dealings and transactions between trustee and *cestui que trust* and agent and his principal, such directors or managers being in fact trustees and agents of the bodies represented by them.[2] Bank directors are not mere agents, like cashiers, tellers and clerks. It is the duty of the board to exercise a general supervision over the affairs of the bank and to direct and control the action of its subordinate officers in all important transactions. * * * They invite the public to deal with the corporation, and when any one accepts the invitation he has the right to expect reasonable diligence and good faith at their hands, and if they fail in either, they violate a duty they owe not only to the stockholders but to the creditors and patrons of the corporation.[3] The directors of a banking or other corporation are, in the management of its affairs, only trustees for its creditors and stockholders, and are bound to administer its affairs according to the terms of its charter and in good faith. If they fail in either respect they are liable to the party in interest who is injured by it for a breach of trust and may be made to account with him in a court of chancery.[4] The character of directors as

[1] Spering's Appeal, (1872) 71 Pa. St. 11.

[2] Cumberland Coal & Iron Co. *v.* Parish, 42 Md. 598; Cumberland Coal & Iron Co. *v.* Sherman, 30 Barb. 553; Stewart *v.* Lehigh Valley Railroad Co., 38 N. J. Law, 505; Gardner *v.* Butler, 30 N. J. Eq. 702; Kitchen *v.* St. Louis, etc., Railway Co., 69 Mo. 224; Chouteau *v.* Allen, 70 Mo. 290; Hubbard *v.* N. Y., etc., Investment Co., 14 Fed. Rep. 679.

[3] United Society *v.* Underwood, 9 Bush, 609. See, also, Bank *v.* Wulfekuhler, 19 Kans. 60.

[4] Bank *v.* St. John, 25 Ala. 566.

agents of a corporation for the management of its affairs for the benefit of its stockholders and creditors forbids the exercise of their powers for their own personal ends against the interest of the corporation. Their position is one of great trust, and to engage in any matter for their personal advantage inconsistent with it would be to violate their duty and to commit a fraud upon the company.[1] They cannot, as agents or trustees, enter into or authorize contracts on behalf of those for whom they are appointed to act and then personally participate in the benefits. Hence all arrangements by directors of a corporation to secure an undue advantage to themselves at its expense, by the formation of a new corporation as an auxiliary to the original one, with an understanding that they, or some of them, should take stock in it, and then that valuable contracts should be given to it, in the profits of which they, as stockholders in the new corporation, are to share, are so many unlawful devices to enrich themselves to the detriment of the stockholders and creditors of the original corporation, and will be condemned whenever properly brought before courts for consideration.[2] A director of a corporation is a trustee of the corporation, and is under the disability which attaches to all trustees in dealing with trust property and in transacting the business pertaining to the trust. He cannot act as trustee and for himself at the same time, and will not be permitted to make a profit to himself in his dealings with the corporation. It is against public policy to allow persons occupying fiduciary relations to be placed in such positions as that there will be constant danger of a betrayal of trust by the vigorous operation of selfish motives.[3]

[1] Wardell *v.* Railroad Co., (1880) 103 U. S. 651.

[2] Ibid.; citing Great Luxembourg Railway Co. *v.* Magnay, 25 Beav. 586; Benson *v.* Heathorn, 1 Y. & Cal. C. C. 326; Flint & Pere Marquette Railway Co. *v.* Dewey, 14 Mich. 477; European & North American Railway Co. *v.* Poor, 59 Me. 277; Drury *v.* Cross, 7 Wall. 299.

[3] Barnes *v.* Brown, (1880) 80 N. Y. 527; citing Risley *v.* Indianapolis, B. & W. R. R. Co., 62 N. Y. 240; Butts *v.* Wood, 37 N. Y. 317; Stewart *v.* Lehigh Valley R. R. Co., 38 N. J. Law, 505; Gardner *v.* Butler, 30 N. J. Eq. 702; Foster *v.* Oxford, W. & W. Ry. Co., 14 Eng. Law & Eq. 306; Aberdeen Ry. Co. *v.* Blakie, 1 MacQueen H. L. 461. As to the duties of directors and the restrictions upon their action in matters of the corporation growing out of their trust relation in Bird Coal & Iron Co. *v.* Humes, (1893) 157 Pa. St. 278; s. c., 27 Atl. Rep. 750; 33 W. N. C. 174, Mr. Justice Dean said: "A director is a trustee for the entire body of stockholders, and both good morals and good law imperatively demand he shall manage all the business affairs of the company with a view to promote, not his own interests, but the common interests, and he cannot directly or indirectly derive any personal profit and advantage by reason of his position distinct from his co-shareholders. 1 Potter on Corp. § 330; Moraw. on Corp. 517, 518. And by assuming the office he undertakes to give his best judgment in the interests of the corporation in all matters in which he acts for it untrammeled by any hostile interest in himself or others. There is an inherent obligation as his part that he will in no manner use his position to advance his own interest as an individual as distinguished from that of the corporation. Cumberland Coal & Iron Co. *v.* Parish, 42 Md. 598; Hill *v.* Frazier, 22 Pa. St. 320. And all secret profits derived by him in any dealings in regard to the corporate enterprise must be accounted for to the corporation, even though the transaction in which they were made advantaged the corporation of which he was director. Parker *v.* Nickerson, 112 Mass. 195." Fiduciary relation of directors to shareholders discussed, and English and American decisions on the subject examined. 26 Can. Law J. 66. In McGourkey *v.* Toledo & Ohio Central Ry. Co., (1892) 146 U. S. 536, a case involving the right of the purchasers of railway property under a foreclosure sale to certain rolling stock which was claimed to be the property of those representing a "contract," the Supreme Court of the United States, speaking through Mr. Justice Brown, thus refers to the acts of the directors in the matter: "The directors of this road were evidently acting in two inconsistent capacities. As directors they were bound to watch and protect the interests of the road and obtain the rolling stock upon the most advantageous terms. As holders of the car trust certificates, or representatives of such holders, it was to their interest to lease the same at the best possible rate and to make sure that as directors this rolling stock should never become their property except at the highest price. In other words, they were both buyers and sellers or lessors and lessees of the same property," and their action was condemned by the court upon authority of the cases of Wardell *v.* Railroad Co., 103 U. S. 651; Gilman, etc., Railroad Co. *v.* Kelly, 77 Ill. 426; Whelpdale *v.* Cookson, 1 Ves. Sr. 9; Drury *v.* Cross, 7 Wall. 299; York Buildings Co. *v.* Mackenzie, 3 Paton (Scotch) App. Cas. 378; People *v.* Overyssel Township Board, 11 Mich. 222, and others. The competency of the mortgagee to impeach this transaction was questioned in McGourkey *v.* Toledo & Ohio Central Ry. Co., *supra*. Upon this question it was said: "A contract of this kind is clearly voidable at the election of the corporation, and when such corporation is represented by the directors against whom the imputation is made, and the scheme was in reality directed against the mortgagees, and had for its very object the impairment of their security by the withdrawal of the property purchased from the lien of their mortgage, it would be manifestly unjust to deny their competency to impeach the transaction. The principle itself would be of no value if the very party whose rights were sacrificed were denied the benefits of it."

§ 182. General rules continued.—A director of a corporation cannot become a contractor with the corporation nor can he have any personal or pecuniary interest in a contract between the cor-

poration and a third person.[1] A board of directors who have made a barter of the assets of the corporation for personal gain cannot, by an act purporting to be an acceptance for the corporation of an equivalent for the assets, conclude the stockholders or their representatives from showing that no equivalent was actually received.[2] Officers of a corporation have the custody and charge of its property, and occupy the relation of trustees of the stockholders. They have no right to enter into or participate in a combination as, in this case, with a holder of a few bonds secured by a mortgage of the property of the corporation, a railroad company, who had obtained a judgment upon his bonds in a state court and entered into an agreement with certain officers to have a sale of the property in an obscure place unknown to others interested and buy in the property, the object of which combination is to divest the corporation of its property and obtain it for themselves at a sacrifice, or at the lowest price possible. To seek their own profit at the expense of the corporation, its stockholders, or even its bondholders, is forbidden by their relation to the corporation.[3] It being the duty of a director of a corporation to know its financial condition, he cannot avail himself of any dereliction of such duty to secure a personal advantage over other creditors of the corporation.[4] Directors acting honestly for what they esteem the best interests of the corporation, and not willfully perverting their powers, but only misjudging them, will not be held to account for money expended in such case.[5] The directors of a corporation created for the sale of lands may reject offers for the lands, this being within their discretion, and though imprudently done, if there be no fraud, they will not be liable for any loss resulting therefrom.[6] Where expenditures may be made by directors of a corporation in carrying out its prime object, even if such expenditures be *ultra vires*, stockholders knowing of them and not objecting until long after their completion, cannot compel the directors of the corporation

[1] Port *v.* Russell, 36 Ind. 60.

[2] Guild *v.* Parker, 43 N. J. Law, 430.

[3] Jackson *v.* Ludeling, (1874) 21 Wall. 616, ordering the setting aside and canceling as fraudulent and void the sale and purchase of the property by these conspirators and holding them to account for all moneys and profits received by them out of the property or its use.

[4] Clay *v.* Towle, 78 Me. 86; s. c., 2 Atl. Rep. 852.

[5] Watts' Appeal, (1875) 78 Pa. St. 370.

[6] Ibid.

to account for the moneys expended.[1] When the act of directors of a corporation complained of is to be followed by large expenditure of money a stockholder should not only make his protest within a reasonable time, but should follow it up by active preventive measures. Six years', for instance, omission to proceed will effectually bar a stockholder's right to an action against directors for the misuse of corporate property.[2] A court of equity will set aside the sale of corporate property sold for much less than its value, on a sale by trustees of a corporate mortgage, if shown that one of the trustees had accepted a bribe.[3] A contract in the name of a corporation, by its board of directors, is not void, if otherwise unassailable, simply because some of the directors constituting a minority may use their position with the effect, or even for the purpose, of advancing their personal interests to the injury of the corporation they assume to represent.[4] The courts will refuse to enforce an agreement between a director of a corporation and a third party whereby the director agrees to use his vote and influence to the disadvantage of the corporation.[5] Directors of a corporation, as they are managing the funds as trustees of the stockholders, have no right to use or appropriate the funds of their *cestui que trust* to themselves. They have no power to waste, destroy, give away or misapply it, and, therefore, where there is no salary provided for their services they are not authorized to vote one to themselves or to any one of their number.[6] A court of equity will scrutinize with vigorous and jealous observation any attempt of directors of a corporation to make a pledge of its assets in favor of themselves.[7] Directors and officers of a corporation from their position of trust, which requires that they act in the utmost good faith, will not be allowed to deal with corporate funds and property for their private gain.[8] The application of the corporate assets of an insolvent corpora-

[1] Ibid.

[2] Ibid.

[3] White Mountains Railroad *v.* White Mountains (N. H.) Railroad, 50 N. H. 50.

[4] Jesup *v.* Illinois Central R. Co., (1890) 43 Fed. Rep. 483.

[5] Attaway *v.* Third National Bank, (1887) 93 Mo. 485; s. c., 5 S. W. Rep. 16.

[6] Holder *v.* La Fayette, Bloomington & Mississippi Ry. Co., (1873) 71 Ill. 106; Gridley *v.* La Fayette, Bloomington & Mississippi Ry. Co., (1873) 71 Ill. 200.

[7] Chouteau *v.* Allen, (1879) 70 Mo. 290.

[8] Ward *v.* Davidson, (1886) 89 Mo. 445.

tion to debts due the officers, to the exclusion of other creditors, by such officers will not be permitted.[1] A trustee of a corporation can make no agreement for the appropriation of the property of the corporation, authorized by his own vote, that will be valid against the corporation. And where an action is brought against a trustee to compel him to account to the corporation for its property thus appropriated, he cannot defend on the ground that he was a creditor of the corporation and voted as one of its trustees to transfer the property of the corporation to himself as a creditor to pay the debt of the corporation due to him, and then, at a subsequent meeting of the board, by his own vote, carried a resolution to ratify such disposition of the property.[2] In a case where the controlling directors of two corporations were the same persons it was held that a preferential mortgage given by one to the other, as security for payments and liabilities resulting from an acceptance of drafts by the latter for the accommodation of the former, was invalid because it operated to protect the officers of the accepting company against personal liability for their maladministration in accepting paper for accommodation.[3] A corporation having been officially declared insolvent by its directors, and they having determined to wind up its affairs with a view of paying its debts, the directors cannot deliver the assets

[1] McNeill *v.* Lacey, (1890) 33 Ill. App. 310. In Hart *v.* Brockway, 57 Mich. 189; s. c., 23 N. W. Rep. 725, where the directors of a railway corporation had collected subscriptions and taken aid notes to be used in building the road and in discharging existing obligations, the court held that an individual director could not apply such funds as he had collected to the payment of his own personal share of any obligation made jointly with the other directors.

[2] Gildersleeve *v.* Lester, (1893) 68 Hun, 532; s. c., 22 N. Y. Supp. 1026.

[3] Hutchinson *v.* Sutton Manufacturing Co., (1893) 57 Fed. Rep. 998. See, also, Lippincott *v.* Carriage Co., 25 Fed. Rep. 577; Howe *v.* Tool Co., 44 Fed. Rep. 231. As to the right of an officer to loan money to a corporation and take a mortgage to secure the loan upon the same terms and in the same manner as other persons, see Mullanphy Savings Bank *v.* Schott (1890) 135 Ill. 655; s. c., 26 N. E. Rep. 640, affirming 34 Ill. App. 500. Cases in which the transactions of the corporation with its directors were held to be valid. Hannerty *v.* Standard Theater Co., (1891) 109 Mo. 297; s. c., 19 S. W. Rep. 82; In re Pyle Works, (1891) 1 Ch. 173. What class of contracts made by directors with each other are voidable. Mallory *v.* Mallory-Wheeler Co., (1891) 61 Conn. 131; s. c., 23 Atl. Rep. 708. An illustration of a case in which a director cannot sell to himself. Green *v.* Hugo, (1891) 81 Tex. 452; s. c., 17 S. W. Rep. 79. As to acts by directors where their interest is adverse to the corporation, see Waite *v.* Mining Co., 36 Vt. 18; Waite *v.* Mining Co., 37 Vt. 608.

of the corporation to one of the board in payment of his debt, to the exclusion of its other creditors.[1]

§ 183. Breaches of trust.— Should directors pay over the funds of a corporation in their hands or in its treasury to an individual upon a pretended claim which they know, or must be presumed to know, is wholly unfounded in law, they will be guilty of a breach of trust.[2] Directors of a bank are personally responsible for damages resulting to the bank from their acts or neglect.[3] The measure of damages in an action against them would be the extent of the injury.[4] Officers of a bank are the agents of the corporation, and will be held liable for the abuse of their trust wherever the agents of an individual will be.[5] Directors are

[1] Williams *v.* Jackson County Patrons of Husbandry, (1886) 23 Mo. App. 132.

[2] Butts *v.* Wood, (1862) 38 Barb. 181. In this case one who was secretary and treasurer of the corporation, as well as one its directors, presented a claim to the board of directors for compensation for his services as secretary, and the claim was allowed and ordered to be paid by the vote of the three directors present, himself being one of them, his father another, and a relative the third. The Supreme Court of New York, in General Term, speaking through JOHNSON, J., said: "The transaction challenges the most jealous and severe scrutiny, even if there was legal color for the claim. But as there was in fact no legal claim the court is in duty bound to pronounce this disposition of the funds of the company, thus made, fraudulent and void as against the other stockholders. It is a clear abuse of trust, and should not be allowed to stand."

[3] Percy *v.* Millaudon, 3 La. 568.

[4] Ibid. In Ilion Bank *v.* Carver, (1857) 31 Barb. 230, it appeared that a director of the bank, its president, pretended to sell his stock, amounting to $15,000, for $17,250, to an irresponsible person, and with the connivance of his son, who was the cashier of the bank, this irresponsible pretended purchaser of stock hypothecated the stock for a loan of the largest amount named above, and received bills of the bank for the same. It was charged in the action that this was a conspiracy between these parties by which the bank was to be crippled and the president to realize for his stock from the bank more than its real value. It was held that whether the transaction was treated as a willful violation of the duty which the president and cashier owed to the bank, growing out of their official relations to it, or as a direct conspiracy to cripple and defraud it, the parties concerned in it were liable to the bank for the damages which it had sustained in consequence of their acts. Further, that in such a case no *laches* on the part of the bank, short of the Statute of Limitations, would constitute a defense to the action.

[5] Austin *v.* Daniels, (1847) 4 Denio, 299. In this case the officers of the bank purchased state stocks to carry on a private undertaking in which they were engaged, and signed a contract obliging the bank to pay for the stock, and then took money from the bank to fulfill their engagement. They

authorized to manage and conduct the business of a corporation, to audit and pay its debts and make such contracts as are within the ordinary scope and business of the corporation. They are not, however, authorized to vote away the funds of the stockholders upon claims known by them to be fictitious or unfounded, for such would be a breach of their trust. They have not the power, as directors, to mortgage or consolidate the corporation with any other corporation, or compel stockholders to surrender up the stock owned by them, or to accept stock in another corporation. This power exists only in the stockholders.[1] Directors of a corporation knowingly issuing bonds of the corporation falsely purporting to be "first mortgage bonds," and placing them in the hands of an agent who sold them to a purchaser who was ignorant of the fact that they were not first mortgage bonds, have been held liable to the purchaser of the bonds who suffered by the deception of the indorsement upon the bonds that they were "first mortgage bonds."[2] It is beyond doubt that the directors of a banking or other corporation are, in the management of its affairs, only trustees for its creditors and stockholders, and are bound to administer its affairs according to the terms of its charter and in good faith. If they fail in either respect they are liable to the party in interest who is injured by it for a breach of trust, and may be made to account with him in a court of chancery.[1] Should a bank allow its stockholders to withdraw its funds to the amount of their subscriptions, and to use them without security, in their private business, such conduct will be a fraud on its creditors which would render its directors liable in equity for the amount so withdrawn, and each agent who participated in the fraud individually responsible for the amount traced to his hands and all profits made from its use.[2] It was further held in this case that the surrender to the bank's agent of its notes, and the acceptance from him of his draft on a third person, was but the substitution of one security for another, and did not extinguish the original liability on the notes, unless the draft was drawn in good faith and accepted as an absolute payment and discharge of the notes; and even if it was through the fraud of the agent accepted as an absolute payment, the fraud would prevent it from so operating.[3] Directors of a moneyed corporation who release shareholders from the payment in full of their shares, would be guilty of a breach of trust.[4]

were held liable to the receiver of the bank for the money so taken. The money, it appeared further, was taken for this purpose by the cashier with the assent of the president, the financial officer of the bank. It was further held that this assent of the president did not protect the cashier, as it appeared that he was a party to the private enterprise in which the money was to be used. As to the liability of the directors of a moneyed institution for improperly obtaining and disposing of the funds or property of the corporation, see Franklin Fire Insurance Co. *v.* Jenkins, 3 Wend. 130. As to the degree of diligence required from directors of a corporation in the case of its corporate affairs, see Scott *v.* Depeyster, 1 Edw. 513.

[1] Kelsey *v.* Sargent, (1886) 40 Hun, 150; citing Blatchford *v.* Ross, 54 Barb. 42.

[2] Clark *v.* Edgar, (1884) 84 Mo. 106, affirming s. c., 12 Mo. App. 345. In Bartholomew *v.* Bentley, (1852) 1 Ohic St. 37, the Supreme Court of Ohio, in which a verdict had been rendered in the Supreme Court on circuit in favor of a holder of bills of a bank against its managing officers under the statute of that state, allowing a recovery against unauthorized bankers, and the case reserved to the Supreme Court on a motion for a new trial, the court denied the motion, holding that the fraud upon the charter, and the combination to defraud the public would prevent those participating in it from claiming any protection under its provisions to escape private responsibility.

§ 184. Officers interested in contracts with a corporation. — Under the general authority giving to the president and cashier of a bank entire control of all financial matters of the bank, unrestricted by the by-laws or rules of the board of directors or stockholders, the Supreme Court of Minnesota has held they could not bind the bank by any contract to which they, or either of them, were parties.[5] A contract made between a

[1] Bank of St. Marys *v.* St. John, Powers & Co., (1854) 25 Ala. 566; citing Attorney-General *v.* Aspinall, 2 Myl. & Cr. 625; Attorney-General *v.* Kell, 2 Beav. 575; Attorney-General *v.* Corp. of Leicester, 7 Beav. 176.

[2] Bank of St. Marys *v.* St. John, Powers & Co., (1854) 25 Ala. 566.

[3] Ibid.

[4] Walton *v.* Hake, (1881) 9 Mo. App. 595.

[5] Rhodes, Assignee, *v.* Webb, (1877) 24 Minn. 292. GILFILLAN, Ch. J., said: "The transaction [in this case], briefly stated, was an attempt by the president to use the property of the bank, this note, [upon which the assignee's suit was brought], in his own private business, in payment for a purchase made for his own benefit. A general authority to transact the business and manage the finances of the bank would not authorize such a use of its property. Nor do we see that the case of defendant is in any way aided by trying to make out of it a satisfaction of the note by substituting for it the promise of [the president] to the cashier that he would pay to the bank the amount of the note; for general authority in the president and cashier to make contracts on behalf of the bank would be subject to the rule of law that an agent or trustee cannot bind his principal, or *cestui que trust*, by a contract

corporation and one of its directors to the pecuniary advantage of that director, if made at a meeting of the board of directors when he is present and takes part in the proceedings, is void.[1] Directors of a railway corporation, to whom it has been confided

made by him on behalf of his principal, or *cestui que trust*, with himself. General authority in these officers to make discounts would not authorize them to bind the bank by discounting their own notes. Such authority to the president of a bank to certify checks drawn on it does not extend to checks drawn by himself. [Citing] Claflin *v.* Farmers & Citizens' Bank, 25 N. Y. 293. This restraint upon agents, and those occupying fiduciary positions, is essential to secure absolutely fair dealing and adequate protection to those whose interests are confided to them." In Adams *v.* Kehlor Milling Co., (1888) 36 Fed. Rep. 212, a preference was granted by the directors of the corporation known to be insolvent to the estate of one who was a director and its president, deceased. The board at the time consisted of three persons; two of whom were brothers of deceased, and one of them his agent voting his stock at corporation meetings. One of the brothers was a creditor of the estate preferred. It was held that the preference under the circumstances was illegal, and that an unsecured judgment creditor of the corporation was entitled to recover of the two directors who were brothers of the deceased, who had voted for the preference, such percentage of his debt as he would have received if the sum wrongfully paid by way of preference had been divided *pro rata* among all the unsecured creditors; but the other director, not being present at any of the meetings of the directors, and not voting for any of the resolutions relating to this preference, was held not to be liable personally, to the judgment creditor. Cases bearing more or less upon the non-enforceability of contracts of directors with the corporation. Conro *v.* Port Henry Iron Co., 12 Barb. 27; Buffalo, etc., R. R. Co. *v.* Lampson, 47 Barb. 533; Morrison *v.* Ogdensburg & L. C. R. Co., 52 Barb. 173; Alford *v.* Miller, 32 Conn. 543; Coons *v.* Tome, 9 Fed. Rep. 532; Stout *v.* Yaeger, 13 Fed. Rep. 802; Gray *v.* New York & Virginia S. Co., 3 Hun, 388; Mayor of Griffin *v.* Inman, 57 Ga. 370; Bestor *v.* Wathen, 60 Ill. 138; Harts *v.* Brown, 77 Ill. 226; Paine *v.* Lake Erie & L. R. Co., 31 Ind. 283; First National Bank *v.* Gifford, 47 Iowa, 575; Cumberland Coal & Iron Co. *v.* Parish, 42 Md. 598; Redmond *v.* Dickerson, 9 N. J. Eq. 515; Gardner *v.* Butler, 30 N. J. Eq. 702; Claflin *v.* Farmers', etc., Bank, 25 N. Y. 293; U. S. Rolling Stock Co. *v.* Atlantic & Great Western R. Co., 34 Ohio St. 450; McAleer *v.* McMurray, 58 Pa. St. 126; West St. Louis Sav. Bank *v.* Shawnee County Bank, 95 U. S. 557; Cook *v.* Berlin Woolen M. Co., 43 Wis. 433. In Hubbard *v.* New York, N. E. & W. Investment Co., (1882) 14 Fed. Rep. 675, 676, NELSON, D. J., said: "A director of a corporation is not absolutely prohibited by law from entering into a contract with the corporation through his co-directors. Whether such a contract is binding upon the corporation must depend upon its terms and the circumstances under which it was made. Owing to the peculiar relation which the directors owe to the corporation, being

[1] Atlanta Hill Mining Co. *v.* Andrews, (1887) 55 N. Y. Super. Ct. 93; citing Butts *v.* Wood, 37 N. Y. 317; Kelsey *v.* Sargent, 40 Hun, 150.

to purchase the right of way for its road, will not be allowed to expend the funds of the corporation in expensive erections upon land necessary for the purpose, and at the same time to purchase or hire the land in their individual right and avail themselves of the title thus acquired to make extortionate demands of the corporation for the use of the land, and in default of submission to such demands, to destroy the erections they may have made as agents for and at the expense of the corporation.[1] That some of the directors and stockholders of a corporation who, as such, voted for a resolution authorizing the execution of mortgages of its property to secure certain debts may have been guarantors and indorsers upon most of them will not invalidate the mortgages.[2] It appeared in a case in the federal courts that the

strictly trustees, and their position being in every sense fiduciary, their contracts with the corporation should be scanned, if not with suspicion, at least with the most scrupulous care. The validity of such a contract must, therefore, depend upon the nature and terms of the contract itself, and the circumstances under which it is made. The motives of the parties are not necessarily material, but the effect of the provisions of the contract must be especially regarded, and if they are pernicious and tend to work a fraud on the rights of the corporation and stockholders, in such case the directors must be regarded as having no authority to enter into it." Applying these rules to the case in hand, the court held a contract made by a director with the corporation, granting to him enormous commissions without regard to the debts or other liabilities of the corporation, to affect injuriously the rights of the stockholders and to give this director a right, without regard to the rights of the creditors or the liabilities of the corporation, to be unreasonable and beyond the powers of his co-directors to make with him.

[1] Blake *v.* Buffalo Creek R. R. Co., (1874) 56 N. Y. 485. RAPALLO, J., speaking for the court, said: "Well-settled rules forbade their [the directors] acquiring for themselves the property which it was their duty to acquire for the company, and which was necessary for its purposes. Such a dealing would be equally objectionable as purchasing from the company land which it was their duty to sell on its behalf. In respect to this last class of dealings directors of corporations stand upon the same footing as ordinary trustees. Citing Aberdeen Railway Co. *v.* Blakie, 1 MacQueen, 461; Hoffman Coal Co. *v.* Cumberland Coal & Iron Co., 16 Md. 456; Cumberland Coal & Iron Co. *v.* Sherman, 30 Barb. 553. It is a rule of equity of universal application that no person can be permitted to purchase an interest in property when he has a duty to perform in relation to such property which is inconsistent with the character of a purchaser." [Citing] Ringo *v.* Binns, 10 Pet. 269; Van Epps *v.* Van Epps, 9 Paige, 238; Torrey *v.* Bank of Orleans, 9 Paige, 649; s. c., on appeal, 7 Hill, 260; Carter *v.* Palmer, 1 Dru. & Walsh, 722; York Buildings Co. *v.* Mackenzie, 8 Bro. P. C. 42; Gardner *v.* Ogden, 22 N. Y. 327; Anderson *v.* Lemon, 8 N. Y. 236.

[2] Brown *v.* Grand Rapids Parlor Furniture Co., 58 Fed. Rep. 286; s. c.,

directors of a manufacturing corporation and one other stockholder conceived the idea that more extensive works for their business should be erected. When submitted the proposition failed to receive the approval of the majority of the stockholders. Thereupon these parties, with their own funds, erected such buildings for the purpose of carrying on the same business. The corporation, through its meetings, afterwards determined to purchase this property of these directors and their associate. The latter sold it at a profit to the corporation, but not for an unconscionable price. The directors had refrained from voting in the meeting of stockholders which determined to purchase until it was ascertained by them that a majority of the stock represented favored the purchase. After a lapse of two years a stockholder sought to make these directors account for the profits they had made to the corporation. It was held in the United States Circuit Court for the western district of Pennsylvania that neither the stockholder nor the corporation was entitled to such relief, there having been shown no fraud, nor other conduct contrary to their duty growing out of their fiduciary character on the part of these directors in the transaction.[1] It appeared in another case in the federal court that one, acting as agent for the promoters who subsequently organized a corporation and became its original stockholders, made a contract with another corporation for a safety vault for the use of the corporation the promoters of which he represented. It was to be furnished for $7,250 cash; the agent induced them to give him a contract specifying the consideration to be $13,000, and also upon the statement a false credit of $5,750 as paid by him; for this latter sum he received from the company he represented shares of its stock at par value, which was issued to him in consideration of his supposed payment of that amount. In this action the corporation contracting with the agent was held liable to the company he represented for

7 C. C. A. 225, following Bank of Montreal *v.* J. E. Potts Salt & Lumber Co., 90 Mich. 345; s. c., 51 N. W. Rep. 512. That a contract is not made void by the simple fact that the president of a railroad corporation, unknown to the other directors, has an interest in a construction contract made with the corporation, see Augusta, T. & G. R. Co. *v.* Kittel, 52 Fed. Rep. 63; s. c., 2 U. S. App. 409; 2 C. C. A. 615.

[1] Barr *v.* Pittsburgh Plate Glass Co., (1892) 51 Fed. Rep. 33; affirmed by the United States Circuit Court of Appeals for the third circuit in Barr *v.* Pittsburgh Plate Glass Co., (1893) 57 Fed. Rep. 86; s. c., 6 C. C. A. 260.

the amount which he had thus fraudulently obtained from it. The court also held that the fact that the agent was also a stockholder in the plaintiff corporation did not affect its right to recover for the fraud perpetrated; and further, that where the fraudulent contract was made by defendant's president, who was its managing officer, and made its contracts, the defendant could not escape liability on the ground that this transaction was conducted by the president without its knowledge or concurrence.[1]

§ 185. Directors of an insolvent corporation preferring themselves to other creditors.— The majority of the directors of a manufacturing corporation organized under the laws of Illinois, with knowledge of its insolvency, paid off certain debts of the corporation, for which they were liable as guarantors, and took a judgment note of the corporation therefor, due one day after date, without grace, under which judgment was confessed in favor of such directors, and all the property of the company was levied on by execution issued on that judgment. The Supreme Court of Illinois held that the acts of the directors in attempting to secure themselves at the expense of other creditors were fraudulent and void, and were properly set aside at the instance of such other creditors.[2] The directors of an embar-

[1] Grand Rapids Safety Deposit Co. *v.* Cincinnati Safe & Lock Co., (1891) 45 Fed. Rep. 671.

[2] Roseboom *v.* Whittaker, (1890) 132 Ill. 81. Bailey, J., for the court, in support of this holding, said: "There can be no doubt of the propriety of so much of the decree as declares the judgment by confession to be fraudulent and void as against the creditors of the corporation, and orders it to be vacated. This precise question was fully and elaborately discussed by this court in Beach *v.* Miller, 130 Ill. 162, and the rule there laid down must be held to control the present case. We there held that, so long as a corporation remains solvent, its directors may, with the knowledge of the stockholders, deal with the corporation, loan it money, take security or buy property of it, the same as a stranger; that, during the solvency of the corporation, the directors are the agents or trustees of the stockholders, and owe no duties or obligations to others, but that the instant the corporation becomes insolvent, their relations and duties become materially changed. The assets of the corporation then become a trust fund for the payment of its creditors, and the directors can no longer deal with them for their own advantage, or in such way as to gain priority for themselves over other creditors. They are then within the scope of that wise and equitable rule adopted by courts of equity for the protection of *cestui que trustent* or beneficiaries, which prohibits trustees and persons standing in similar fiduciary relations to exercise their powers or manage or appropriate the property of which they have control for their own profit or emolument,

rassed corporation, holding claims against it which they wished to protect, had the notes of the corporation payable to themselves drawn and antedated, and had them discounted by a bank. They then caused to be executed a deed of trust conveying all the assets of the corporation as security for these notes, among others. It was held in the United States Circuit Court for the western district of Missouri, in a proceeding by unsecured creditors to set it aside, that, being a security for debts upon which the directors were themselves liable as indorsers, it was, in effect, a preference to themselves, and fraudulent and void.[1]

or, as it is sometimes expressed, shall not take advantage of their situation to obtain any personal benefit to themselves at the expense of the *cestui que trust*."

[1] Consolidated Tank Line Co. *v.* Kansas City Varnish Co., (1891) 45 Fed. Rep. 7. PHILIPS, J., after referring to the apparent insolvency of the corporation, said: "When a corporation, in its business affairs, is thus *in articulo mortis*, whatever may yet be maintained on divided opinions as to its right to dispose of its property so as to give a preference to some general creditor, the law is too well settled, at least in this jurisdiction, to admit of extended discussion that its directors cannot make a disposition of the assets so as to secure themselves, directly or indirectly, a preference over general creditors. This is the rule of the Missouri courts. Williams *v.* Jones, 23 Mo. App. 132; Mill Co. *v.* Kampe, 38 Mo. App. 229; Roan *v.* Winn, 93 Mo. 503; s. c., 4 S. W. Rep. 736. It is not too much to say that it is the established doctrine of the federal courts. It is strongly maintained by Judge THAYER in the eastern district of this state. White, etc., Manufacturing Co. *v.* Pettes Importing Co., 30 Fed. Rep. 865; Adams *v.* Milling Co., 35 Fed. Rep. 433. See, also, Lippincott *v.* Carriage Co., 25 Fed. Rep. 577; Koehler *v.* Iron Co., 2 Black, 715–721; Railroad Co. *v.* Howard, 7 Wall. 392; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587. In Graham *v.* Railroad Co., 102 U. S. 161, Mr. Justice BRADLEY said: 'When a corporation becomes insolvent, it is so financially dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors. A court of equity, at the instance of the proper parties, will then take those trust funds, which, in other circumstances, are as much the absolute property of the corporation as any man's property is his. The most recent discussion of this question is to be found in the very able opinion of Judge WOODS, in Howe *v.* Tool Co., 44 Fed. Rep. 231. I cannot better express the strength of the reason why a director should not be permitted to prefer himself, under circumstances like those under review, than by quoting his language: 'A sound public policy and a sense of common fairness forbid that the directors or managing agents of a business corporation, when disaster has befallen or threatens the enterprise, shall be permitted to convert their powers of management and their intimate, or, it may be, exclusive, knowledge of the corporate affairs into means of self-protection, to the harm of other creditors. They ought not to be competitors in a contest of which they must be the judges. The necessity for this limitation upon the right to give preferences among creditors, when asserted by a corporation, may not have been perceived in earlier times, but the growing importance and variety of modern corporate enterprises and interests, I think, will compel its recognition and adoption. * * * Whether or not such preferences are fairly given is an impracticable inquiry, because there can be, in ordinary cases, no means of discovering the truth, and consequently the presumption to the contrary should in every case be conclusive. Concede that it is a question of proof, and that a preference in favor of a director will be deemed valid if fairly given, and it may as well be declared to be a part of the law of corporations that, in cases of insolvency, debts to directors, and liabilities in which they have a special interest, may first be discharged. That will be the practical effect, and the examples will multiply of individual enterprises prosecuted under the guise of corporate organizations for the purpose, not only of escaping the ordinary risks of business done in the owner's name, which may be legitimate enough, but of enabling the promoters and managers, when failure comes, to appropriate the remains of the wreck by declaring themselves favored creditors. Besides, in consistency with that equality which equity loves, such favors involve too many possibilities of dishonesty and successful fraud to be tolerated in an enlightened system of jurisprudence.' The same thought was in the mind of Mr. Justice MILLER, in Sawyer *v.* Hoag, 17 Wall. 620, when he observed: 'When we consider the rapid development of corporations as instrumentalities of the commercial and business world, in the last few years, with the corresponding necessity of adapting legal principles to the new and varying exigencies of this business, it is no solid objection to such a principle that it is modern, for the occasion for it could not sooner have arisen.' It was insisted on behalf of the banks that, although the deed of trust might be voidable as against the directors, yet the banks were to be regarded as *bona fide* purchasers. To this it was said: 'But are the banks such purchasers? In the first place, they parted with nothing on the faith of the deed. They loaned the money, as their evidence shows, on the indorsement of the directors. They never asked for this deed. They did not know of its existence until after it was executed and recorded. They may be accorded the presumption of the law in their favor that where such a deed is for their benefit, they are presumed to accept its provisions. But it is apparent on the face of the deed, and from the facts known to the banks, that the deed inured to the benefit of the directors as indorsers of the notes held by the banks. The banks could not, therefore, take without being privy to the wrong attempted by the directors. If the law were otherwise, the rule could be of no avail which seeks to prevent such directors 'from preferring debts in the payment of which they have a personal interest,' as declared in Adams *v.* Milling Co., 35 Fed. Rep. 435.'"

§ 186. Directors contracting with a syndicate composed of themselves — when such a contract cannot be rescinded. — One of the late cases before the New York Court of Appeals presents as facts that a railroad corporation of that state, through its directors, recognizing the importance of a connection by rail with another point, promoted the building of a street line of railway to accomplish this purpose. The directors of this road

became the directors of the new corporation, and they arranged a plan by which the construction of the road was to be done by a syndicate composed of themselves, and when completed a contract of lease of this connecting road, which had $1,000,000 of bonds issued upon it and $500,000 of shares of stock, the lessee company guaranteeing interest of seven per cent upon the bonds and dividends of seven per cent upon the shares of stock, as a rental for the road. The main corporation, the lessee, going through insolvency, the hands of a receiver, and finally into a new corporation, it having been sold to a purchasing committee, and reorganized, continued to use the property leased. At the suggestion of the receiver the shares of the stock of the lessor company were purchased by the successors of the lessee company to such an amount as would give them control of the company, as a means of reducing the rental of this desirable and indispensable connection. The successors then suspended the payment of the guaranteed dividend upon the shares. This resulted in the bringing of this action by the few individual holders of the stock against the company then using the property under the lease to enforce a specific performance of the contract of guarantee of dividends. The one question as to the liability of the successor of the lessee company remaining, in the opinion of the court, was whether the taint of original fraud in the procurement of the lease operated to prevent the enforcement of the obligations of that instrument. In discussing the question, GRAY, J., delivering the opinion, said: "That the contract of lease was voidable and quite indefensible because of the immoral conduct of the directors, who abused their trust in procuring its execution, I quite concede. The proofs could lead to no other finding than that the lease and the rental guarantee were the work of a combination or syndicate composed of members from the boards of directors of the two companies, who caused the same to be made by the [lessee company] for purposes of their own individual gain and in fraud of that company's rights. The identity of certain of the directors of each company when the lease was made, the interest of four of these common directors in the contract for the construction of the [lessor company's] road, and in the stock and bonds to be guaranteed, as a condition of the leasing of the road, stamped the whole transaction as a fraud upon the [lessee company], and brought it under the condemnation of the rule

which forbids those who fill fiduciary positions from making use of them to benefit their personal interests."[1] But while holding this contract of lease by the lessee railroad corporation and a guaranty of interest on bonds and dividends upon stock to be tainted with fraud by reason of the original transaction and voidable at the option of the lessee corporation, the Court of Appeals held that by acquiescence and use of the property for so long a time the complainant, successor to the original lessee, had so far ratified the contract that it could not ask of a court of equity to rescind it.[2]

§ 187. Directors issuing shares of stock to themselves.— A Kansas corporation, an agricultural society, had been organized with a capital stock of $5,000, divided into 1,000 shares of $5 each, and 590 shares of said stock were subscribed, but no notice was ever given and published where books of subscription would be open. The corporation continued in existence seven years, and became possessed of valuable real estate, and afterwards sold the same. After this sale, the officers and directors of the corporation, without the knowledge or consent of the other stockholders, issued to themselves the remaining stock at par value, and then declared a dividend upon the entire stock issued of $25 per share. In an action by a stockholder to enjoin these officers and directors from paying out such dividend and to cancel the stock issued to themselves, the Kansas Supreme Court held that the action of the officers and directors was without authority and in fraud of the rights of the other stockholders and a plain breach of duty upon the part of such officers.[3]

[1] Barr *v.* New York, L. E. & W. R. R. Co., (1891) 125 N. Y. 263, 274; s. c., 26 N. E. Rep. 145.

[2] Ibid.

[3] Arkansas Valley Agricultural Society *v.* Eichholtz, (1891) 45 Kans. 164. The directors claimed before the court that the taking of stock in a corporation stood upon a different footing than ordinary contracts of corporations in prosecuting the business enterprises for which they are organized; that any person has a right to subscribe for stock in any corporation, so long as there are shares to be taken; that the corporation has no power to prescribe the character or qualification of its stockholders; that the policy of the law, as declared by express terms of the statute, is to make corporations open to all persons alike to become members and stockholders, etc. The Supreme Court said: "This rule, as applied to the directors or officers of a corporation, cannot be upheld. The principle of public policy forbids transactions of this kind. It appears from the evidence that the property owned by this corporation had been sold, and the proceeds [of the sale]

§ 188. Officers profiting by their relation to the corporation.— The directors of a corporation cannot speculate with the funds or credit of the corporation and appropriate to themselves the profits of the speculation; neither can they make sales, as purchasers for the corporation, and take advantage of their position as directors, and either directly or indirectly speculate upon the corporation.[1] Holding the fiduciary relation they do to the stockholders of the corporation, its directors and managers cannot be permitted to acquire interests adverse to such relation.[2] Thus, a director contracting with certain parties for the construction of a railroad for the corporation he represents, cannot receive or

held by its officers. The assets at the time of the sale belonged to the then stockholders, and the directors and officers had no right to subscribe for the remaining stock at par, and enrich themselves to the detriment and loss of the other shareholders. The directors cannot lawfully benefit or favor any particular shareholder or class of shareholders. Every authority possessed by them is a power and discretion in the directors, who are trustees for the benefit of all the shareholders alike, which is to be exercised for the benefit of all of them. 1 Waterman on Corp. 620; Harris *v.* N. D. Rld. Co., 20 Beav. 384. The effort on the part of the directors and officers of a society to obtain the unsubscribed stock at par, when they knew that each share of the stock already issued was worth eighteen times its face value, was clearly a fraud upon the rights of the other stockholders, and a flagrant violation of their duties as directors and officers of such association. The officers and directors of a corporation are trustees of the stockholders, and in securing to themselves an advantage not common to all the stockholders, they commit a plain breach of duty. Koehler *v.* Iron Co., 2 Black, 715; Shorb *v.* Beaudry, 56 Cal. 446; 1 Morawetz Private Corp. § 518. The law does not permit directors to manage the affairs of a corporation for their personal and private advantage, and this rule, we think, applies to the disposition of unsubscribed stock, as well as to other contracts. The character and relation of directors and officers of a corporation require of them the highest and most scrupulous good faith in their transactions for the corporation and the stockholders." Hale *v.* Bridge Co., 8 Kans. 466, and authorities there cited; Ryan *v.* L. A. & N. W. Ry. Co., 21 Kans. 365; Hentig *v.* Sweet, 33 Kans. 244. As to what directors may do, see Holder *v.* La Fayette R. R. Co., 71 Ill. 106; Rollins *v.* Clay, 33 Me. 132; Abbott *v.* American Hard Rubber Co., 33 Barb. 578; Bedford R. Co. *v.* Bowser, 48 Pa. St. 29; Taylor *v.* Miami Export Co., 5 Ohio, 162; 19 Cent. Law J. 305–310; 18 Cent. Law J. 130; Union Mut. Life Ins. Co. *v.* Frear Stone Mfg. Co., 97 Ill. 537; Burke *v.* Smith, 16 Wall. 390; Penobscot R. Co. *v.* Dunn, 39 Me. 587.

[1] Redmond *v.* Dickerson, (1853) 9 N. J. Eq. 507. As to president and directors not being allowed to speculate in claims against the corporation, see McDonald *v.* Haughton, (1874) 70 N. C. 393.

[2] European & North American Ry. Co. *v.* Poor, 59 Me. 277.

retain any part of the profits arising from the contract for his personal use and benefit.[1] Where directors of a ferry company, in their individual names bought a steamboat, and then, as directors, purchased it of themselves for the corporation at a large advance on its cost and value, the transaction was held to be a fraudulent one; it was held, also, that the profits made by the directors inured to the benefit of the corporation, and that the latter could recover the profits from them, with interest.[2] The rule generally is that one acting in a representative or fiduciary capacity is not allowed so to deal with the subject-matter of his agency or trust as to benefit himself privately, and an agent or trustee who thus makes a profit out of his agency or trusteeship must account for the same to his principal or *cestui que trust;* and it may be conceded that the rule applies, as a principle of public policy, without regard to the actual fairness of the transaction, or the merits of the services rendered, or the price paid, in case of a sale or purchase.[3] Where it was represented by promoters of a mining corporation, who afterwards became its trustees, that it would take the proceeds of the whole of its capital stock to purchase certain mining properties, and the trustee, to whom the whole stock was turned over for the purpose, actually purchased it with the payments made for certain shares of stock, less than half the issue, and appropriated the rest of the shares of stock to himself and others, without actually paying any money, and concealed the facts from the stockholders who had paid for their shares, it was held that

[1] Ibid.

[2] Parker *v.* Nickerson, (1873) 112 Mass. 195.

[3] Bristol *v.* Scranton, (1893) 57 Fed. Rep. 70, 78; citing Sugden *v.* Crossland, 3 Smale & G. 192; McKay's Case, 2 Ch. Div. 5; Pearson's Case, 3 Ch. Div. 807; Parker *v.* McKenna, L. R., 10 Ch. App. 96; Iron Works Co. *v.* Grave, 12 Ch. Div. 738, 746; Railway Co. *v.* Blakie, 1 Macq. 461; Wardell *v.* Railroad Co., 103 U. S. 651, 658. In Keokuk Northern Line Packet Co. *v.* Davidson, 95 Mo. 467; s. c., 8 S. W. Rep. 545, it was held that the president of the packet company, after having endeavored to obtain contracts for carrying the mails for the company, was not precluded from making such contracts in his own name, but, having done so, he using all the facilities afforded by the company in performing them, would not be allowed to make profit out of such use, but would be held to account to the company for all that he received for the services performed by it. For an illustration of what will not be held a fraudulent sale to a corporation, where parties purchasing property at a low figure before the organization of a corporation sold it at a much larger figure to the corporation, but there was some evidence of fraud or deception, see Stewart *v.* St. Louis, Fort Scott & W. R. Co., 41 Fed. Rep. 736.

this defendant occupied a fiduciary relation to the corporation and the subscribers, and could not, nor could his associates, who were also familiar with the facts, make, through concealment from the subscribers, any profit from the transaction, and they should be held accountable for the stock which they had retained, or its proceeds.[1] The law will not permit, for instance, one in whose person are vested the offices of vice-president and treasurer of a corporation with the management and control of the corporation

[1] Brewster *v.* Hatch, (Sp. Term Sup. Ct. 1881) 10 Abb. N. C. 400; citing Blake *v.* Buffalo Creek R. R. Co., 56 N. Y. 485; Cumberland Coal & Iron Co. *v.* Sherman, 30 Barb. 553; Bagnall *v.* Carlton, L. R., 6 Ch. Div. 371; Erlanger *v.* New Sombrero Phosphate Co., L. R., 3 App. Cas. 1218; Simons *v.* Vulcan Oil & Mining Co., 61 Pa. St. 202. In East New York & Jamaica R. R. Co. *v.* Elmore, (1875) 5 Hun, 214, it appeared that the corporation had subscribers for seventy-two shares of its stock, who had agreed to pay par value for it. All the shares within its power to issue having been already issued, the treasurer and president purchased the number of shares at a price far below par, and transferred them to those subscribers on the corporation's books, charging the corporation par value for them. In an action against the treasurer to recover the profits he made in the transaction, it was held that the treasurer could not, by charging over the stock at its par value, make the corporation his debtor, and thus extinguish his liability for moneys received by him or its treasurer. For an illustration of when a purchase by one trustee, and, at the same time treasurer, of a corporation in his own behalf will inure to the benefit of the corporation, see Einsphar et al., Trustees First German Lutheran Zion Church of Adams Co. *v.* Wagner, (1882) 12 Neb. 458. As to when and the circumstances under which a mortgage of the personal property of a corporation executed to its president, who was also a director, by his vote and that of another of the three directors, will be held fraudulent, see Burley *v.* Marsh, (1881) 11 Neb. 291. As to officers and stockholders contracting with corporation, see Charter Gas-Engine Co. *v.* Charter, 47 Ill. App. 36; Central Trust Co. *v.* Bridges, 57 Fed. Rep. 753; s. c., 6 C. C. A. 539; Barr *v.* Pittsburgh Plate Glass Co., 57 Fed. Rep. 86; s. c., 6 C. C. A. 260; Foster *v.* Belcher's Sugar Refining Co., 118 Mo. 238; s. c., 24 S. W. Rep. 63; Wile & Brickner Co. *v.* Rochester & K. F. Land Co., 4 Misc. Rep. 570; s. c., 25 N. Y. Supp. 794; Milbank *v.* Welch, 74 Hun, 497; s. c., 26 N. Y. Supp. 705. As to directors dealing with themselves or acting in matters where they are interested, see Coleman *v.* Second Avenue R. R. Co., 38 N. Y. 201; Blatchford *v.* Ross, 5 Abb. Pr. (N. S.) 434; s. c., 37 How. Pr. 110; 54 Barb. 42; Ogden *v.* Murray, 39 N. Y. 202; Bliss *v.* Matteson, 45 N. Y. 22. As to various rules governing contracts in which directors have an interest, see Duncomb *v.* New York, Housatonic & Northern R. R. Co., 84 N. Y. 190; Western R. R. Co. *v.* Bayne, 11 Hun, 166; Barnes *v.* Brown, 80 N. Y. 527. As to a contract with a corporation entered into at a special meeting of directors being void because of absent directors not having notice, see Hill *v.* Rich Hill Coal Min. Co., (Mo. 1894) 24 S. W. Rep. 223; Minneapolis Times Co. *v.* Nimocks, 53 Minn. 381.

also allowed him, to so manage the affairs of the corporation as to result to his own pecuniary advantage. And in case such an officer speculate in the funds of the corporation, or buy claims against it at a discount, he will be required to account to the creditors or stockholders of the corporation for any profit that results from such transactions.[1] The contract made by a director of a corporation to secure a personal advantage to himself will be

[1] Thomas *v.* Sweet, (1887) 37 Kans. 183; s. c., 14 Pac. Rep. 545. For a strong opinion on the subject of the duties of officers to the corporation, see Ryan *v.* L., A. & N. W. Ry. Co., 21 Kans. 365. In Powell *v.* Willamette Valley R. R. Co., (1887) 15 Or. 393; s. c., 15 Pac. Rep. 663, where the attorney, who was also a director in an insolvent corporation, had been employed by third parties to buy up the claims of creditors of the corporation with a view to its reorganization, it was held that his relation to the company required of him the utmost good faith towards the creditors of the company in his dealings with them in the matter, but where they had received all that their claims were worth, the fact that he had not informed them of the contemplated reorganization would not constitute a fraud upon the creditors upon this attorney and director's part. In Smith *v.* Los Angeles Immigration & Land Co-operative Assn., (1889) 78 Cal. 289; s. c., 20 Pac. Rep. 677, a resolution of a quorum of four directors, authorizing renewal of notes of the corporation in favor of two of the four directors, was held to be void and of no effect. In Rudd *v.* Robinson, (1889) 54 Hun, 339; s. c., 7 N. Y. Supp. 535, the corporation had been formed under the laws of New York, and succeeded to the business of a firm. One holding a claim against this firm was a trustee of the corporation, and with two others of the board constituted a majority. These two, it was shown, represented the first named, or acted in concert with him in any matters in which he was interested. He had from time to time aided with money the corporation upon call. Finally he had had action taken by the board of trustees, by which he had himself paid a debt out of the corporation's funds which he held against the firm which it succeeded. The Supreme Court of New York held that he should account to the receiver of the corporation for this money received for this debt of the firm, together with interest upon it, and also for all excess of interest over and above legal interest which, through the action of himself and other trustees, he had received upon moneys advanced to the corporation, as also the profits he had received in certain transactions and "ventures" in which he had advanced the money and arranged for a division of the profits between himself and the corporation, upon the ground that he had no right to share in the profits of the business which belonged exclusively to the corporation itself. An illustration of when the profits of a director must inure to the benefit of the corporation: Paducah Land, Coal & Iron Co. *v.* Hays, (Ky. 1893) 24 S. W. Rep. 237. As to the effect of laches of a stockholder in complaining of a profit made by a director in connection with a sale of the stock of a corporation, and an illustration of what a director might do for which he would not be held accountable, see Keeney *v.* Converse, (1894) 99 Mich. 316; s. c., 58 N. W. Rep. 325.

held to be void or to inure to the advantage of the corporation.[1] An agreement made by a majority of the directors of a corporation among themselves, privately and unofficially, that they should be paid a percentage upon all the money raised upon the credit of a bond of indemnity, signed by them, against the future indebtedness of the corporation, has been held not to be binding upon the corporation.[2] Directors or other officers of a corporation contracting with another for work and material, paying an excessive price for the same, and reserving to themselves a discount or commission, will be held to an accountability to the corporation for what they have profited.[3] Where directors own all

[1] Sargent *v.* Kansas Midland R. R. Co., (1891) 48 Kans. 672; s. c., 29 Pac. Rep. 1063.

[2] Butler *v.* Cornwall Iron Co, (1853) 22 Conn. 335.

[3] Perry *v.* Tuskaloosa Cotton Seed Oil Mill Co., (1890) 93 Ala. 364; s. c., 9 So. Rep. 217. In Farmers & Merchants' Bank of Los Angeles *v.* Downey, (1879) 53 Cal. 466, where a director of the bank who had taken from the borrowers a note running to the bank for the principal sum loaned, at a rate of interest therein stipulated, but at the same time, and as part of the same transaction, made an agreement with the borrowers that they should permit him to participate with them in the profits of a purchase and sale of certain lands, it was held that he could not be permitted to retain for himself the profits thus contracted for, but must surrender those profits to the bank for the benefit of all the stockholders. As to a city treasurer making profit on public funds, see City of Chicago *v.* Gage, 95 Ill. 593. As to officers accounting to the corporation or stockholders or creditors of the corporation for profits growing out of transactions in behalf of the corporation in which they are interested, see Ward *v.* Davidson, (1890) 89 Mo. 445; s. c., 1 S. W. Rep. 846. In Hutchinson *v.* Bidwell, (1893) 24 Or. 219; s. c., 33 Pac. Rep. 560, it appeared that the directors of an insolvent milling company leased the corporate property to themselves and operated the plant at a profit. The Supreme Court held that the directors were liable to account to the creditors of the corporation for the profits under the lease. In McClure *v.* Levy, (1894) 79 Hun, 235; s. c., 29 N. Y. Supp. 352, it appeared that one who had secured his election as president of a life insurance association and secured a board of directors subservient to his will, had gained possession of certain notes of the association which he had full knowledge could not be paid out of the reserve fund of the association. He had this board order the payment of the notes by drawing all the funds the association had in bank properly belonging to the reserve fund in his favor. The Supreme Court of New York in General Term held that the receiver of the association was entitled to recover from him the money thus wrongfully misappropriated through his and other willing directors' action. That a president and vice-president of a railroad company who had arranged to use certain bonds of the company secured by mortgages for their own private use instead of improving the railroad property, has been held to be such a fraud on the mortgage trustee and the bondholders as would enable a

the stock of a corporation they are not within the rule prohibiting persons in a fiduciary relation from contracting for their own advantage in the name of their *cestui que trust*.[1]

court of equity, at the suit of one of the bondholders, to compel them to appropriate the proceeds of the bonds thus unlawfully diverted to the purpose specified in the mortgage. Belden *v.* Burke, 72 Hun, 51; s. c., 25 N. Y. Supp. 601. It was held in Paducah Land, Coal & Iron Co. *v.* Mulholland, (Ky. 1894) 24 S. W. Rep. 624, that stock which was returned to directors purchasing land for the corporation to be used for their own personal benefit, should be surrendered for cancellation unless in the hands of *bona fide* purchasers for value. For a case holding that the acts of the president and trustees of a corporation in a reorganization, of the same, were not fraudulent, although a large personal profit accrued therefrom to the president who was the principal promoter of the reorganization, see Symmes *v.* Union Trust Co., 60 Fed. Rep. 830.

[1] McCracken *v.* Robison, 57 Fed. Rep. 375; s. c., 6 C. C. A. 400. That directors in a private corporation have no right, under any circumstances, to use their official position for their own individual benefit, see Hoffman *v.* Reichert, (1893) 147 Ill. 274; Gilman, Clinton & Springfield R. R. Co. *v.* Kelly, 77 Ill. 426, 434; Hoyle *v.* Plattsburg & Montreal R. R. Co., 54 N. Y. 314; Oliver *v.* Piatt, 3 How. 333; Speidel *v.* Henrici, 120 U. S. 377, 386; Railroad Co. *v.* Durant, 95 U. S. 576; Van Epps *v.* Van Epps, 9 Paige, 241. Contracts of corporations made with officers. President, etc., *v.* Ry. Co., 44 Cal. 106; Pickett *v.* School District, 25 Wis. 552; Cumberland Coal Co. *v.* Sherman, 30 Barb. 553; Port *v.* Russell, 36 Ind. 64; Railway Co. *v.* Poor, 59 Me. 277; Gardner *v.* Butler, 30 N. J. Eq. 702; Davis *v.* Mining Co., 55 Cal. 359; Copeland *v.* Manufacturing Co., 47 Hun, 235; Thomas *v.* Railway Co., 1 McCrary, 392. That they are not absolutely void: Bundy *v.* Jackson, 24 Fed. Rep. 628; Bank *v.* Patterson, 7 Cranch, 299; Canal Bridge *v.* Gordon, 1 Pick. 296; Harts *v.* Brown, 77 Ill. 226. What may make them valid: 1 Beach on Priv. Corp. 402; Battelle *v.* Northwestern Cement Co., 37 Minn. 89; Pneumatic Gas Co. *v.* Berry, 113 U. S. 322; Knowles *v.* Duffy, 40 Hun, 485; Santa Cruz Co. *v.* Spreckles, 65 Cal. 193; Hill *v.* Nisbet, 100 Ind. 341; Richardson *v.* Green, 133 U. S. 30; Union Mut. Life Ins. Co. *v.* White, 106 Ill. 68; Smith *v.* Smith, 62 Ill. 493; Addison *v.* Lewis, 75 Va. 701; Stratton *v.* Allen, 16 N. J. Eq. 229. As to the effect of directors or other officers of corporation being interested in contracts, see County Court *v.* Baltimore & Ohio R. R. Co., 35 Fed. Rep. 161; Holt *v.* Bennett, 146 Mass. 436; s. c., 16 N. E. Rep. 5; Hancock *v.* Holbrook, 40 La. Ann. 53; s. c., 3 So. Rep. 351; Wasatch Min. Co. *v.* Jennings, 5 Utah, 385; s. c., 16 Pac. Rep. 399. As to a director dealing with the corporation for his own profit, see Schetter *v.* Southern Oregon Improvement Co., (1889) 19 Or. 192; s. c., 24 Pac. Rep. 25. As to a president and trustee joining in voting himself compensation for services, see Copeland *v.* Johnson Manufacturing Co., (1890) 47 Hun, 235. Transactions by officers with corporations: Raymond *v.* San Gabriel Val. Land & Water Co., 53 Fed. Rep. 883; Langan *v.* Francklyn, 29 Abb. N. C. 102; s. c., 20 N. Y. Supp. 404; Miner *v.* Belle Isle Ice Co., 93 Mich. 97; s. c., 53 N. W. Rep. 218; Beers *v.* New York Life Ins. Co., 66 Hun, 75; s. c., 20 N. Y. Supp. 788; Main Jellico Mountain Coal Co. *v.* Lotspeich, (Ky. 1894) 20 S. W. Rep. 377; Prince

§ 189. Repudiating or avoiding contracts made by officers with themselves.— A contract made by a director of a corporation with himself may be repudiated by the corporation at the instance of the stockholders.[1] If the directors of a corporation exceed their authority or are recreant to their trust, the corporation may repudiate their fraudulent contracts.[2] Contracts made by the directors of a corporation with one of their number are voidable at the election of the corporation, without reference to the question whether or not they are beneficial to the corporation.[3] This doctrine may be applied where the contract is made by nominal directors who are in fact the mere instruments of the other contracting party, and act under his directions and as he wishes, in pursuance of a scheme planned by him by which they were placed in office, and a contract thus made would be voidable at the election of the corporation without proof of unfairness or fraud.[4] In order to defeat a contract entered into by its directors or in its behalf, in which one or more of them had a private interest, a corporation is not bound to show that the influence of the director or directors having the private interest determined the board's action.[5]

Manufg. Co. *v.* Prince's Metallic Paint Co., 20 N. Y. Supp. 462; Hannerty *v.* Theater Co., 109 Mo. 297; Societe des Mines D'Argent et Fonderies de Bingham *v.* Mackintosh, 7 Utah, 35.

[1] Gardner *v.* Butler, 30 N. J. Eq. 702; Guild *v.* Parker, 43 N. J. Law, 430.

[2] Metropolitan Elevated Ry. Co. *v.* Manhattan Ry. Co., (Spl. Term Sup. Ct. 1884) 14 Abb. N. C. 103, 212.

[3] Central Trust Co. *v.* N. Y. City & Northern R. R. Co., (Spl. Term Sup. Ct. 1887) 18 Abb. N. C. 381.

[4] Ibid.

[5] Munson *v.* Syracuse, Geneva & Corning R. R. Co., (1886) 103 N. Y. 58; s. c., 8 N. E. Rep. 355, affirming 29 Hun, 76; s. c., 16 N. Y. Wkly. Dig. 212. ANDREWS, J., said: "The law cannot accurately measure the influence of a trustee with his associates, nor will it enter into the inquiry, in an action by the trustee in his private capacity to enforce the contract in the making of which he participated. The value of the rule of equity, to which we have adverted, lies to a great extent in its stubbornness and inflexibility. Its rigidity gives it one of its chief uses as a preventive or discouraging influence, because it weakens the temptation to dishonesty or unfair dealing on the part of trustees, by vitiating, without attempt at discrimination, all transactions in which they assume the dual character of principal and representative. This rule has been declared and enforced in a great variety of cases, but in none perhaps with more vigor and completeness, but upon principle and authority, than in the leading case of Davoue *v.* Fanning, 2 Johns. Ch. 251, 252. But the case of Aberdeen Railway Company *v.* Blakie & Others, 2 Eq. 1281, decided by the

§ 190. Rules as to such contracts.— The relation as a director and officer to a corporation does not preclude him from entering into contracts with it, making loans to it and taking its bonds as collateral security; but courts of equity regard such personal transactions of a party in either of these positions not, perhaps, with distrust, but with a large measure of watchful care, and unless satisfied by the proof that the transaction was entered into in good faith, with a view to the benefit of the company, as well as of its creditors, and not solely with a view to his own

House of Lords, is in many of its features similar to the present one. In that case it appeared that the plaintiffs were a manufacturing firm, and that one of them was also a manager of the Aberdeen Railway Company, the defendant, and the chairman of the board. At a meeting of the managers, they by resolution authorized their engineer to contract for iron chairs needed by the company. The agent contracted with the plaintiffs' firm. It did not appear that the member of the firm, who was also a manager and the chairman of the company, intermeddled with the dealing on either side, further than that it may be assumed he was at the meeting which authorized the engineer to procure a supply of chairs. The plaintiffs brought their suit to enforce specifically the performance of the contract, or in the alternative to recover damages for its non-performance. After a decision in their favor in the lower court, the company appealed to the House of Lords, where the ruling was unanimously reversed on the ground that the contract was condemned by the rules of equity, as having been made between the company of which one of the plaintiffs was a manager and a private firm of which he was a member. The opinions of Lord Chancellor CRANWORTH and of Lord BROUGHAM vindicate upon impregnable grounds the general rule and its application to the particular case." VAN BRUNT, J., in Metropolitan Elevated Ry. Co. *v.* Manhattan Ry. Co., (Spl. Term Sup. Ct. 1884) 14 Abb. N. C. 103, 272, said: "The undoubted rule of law in this state is, that every contract entered into by a director with his corporation may be avoided by the corporation within a reasonable time, irrespective of the merits of the contract itself. * * * I can see no difference in principle between the case of a director contracting with his corporation and that of directors of one corporation contracting with themselves as directors of another corporation. The evils to be avoided are the same, the temptations to a breach of trust are the same, the want of independent action exists, and the divided allegiance is just as apparent." As to rules governing where directors act in their own interest, see March *v.* Eastern Railroad, 43 N. H. 515; Fisher *v.* Concord Railroad, 50 N. H. 200; Richards *v.* New Hampshire Ins. Co., 43 N. H. 263; Ashuelot Railroad *v.* Elliott, 57 N. H. 397. As to the acts of school trustees, so far as they should be beneficial to themselves, being void, see Rhodes *v.* McDonald, 2 Cushman, (Miss.) 418. As to contracts between a director and a corporation, being voidable only, see Stewart *v.* Lehigh Valley R. R. Co., (1876) 38 N. J. Law, 505.

benefit, they refuse to lend their aid to its enforcement.[1] In this case, plaintiff's testator loaned to a railway corporation $100,000 upon its notes, and received from it 1,250 shares of paid-up stock as a bonus, and 200 mortgage bonds of the corporation, and the practical control of its board of directors. After this, he demanded of this board 100 more bonds, as further collateral, and they agreed to it. Subsequently, this board allowed him to have 300 more bonds, as collateral security for further advances of money, but he made no such further advances of money to the corporation. These 400 bonds he obtained at a time when he was acting as, and claiming to be, the treasurer of the corporation. After the corporation became insolvent he claimed to hold these 400 bonds, individually, as collateral for his debt. The Supreme Court of the United States held that, as between him and the creditors of the railway corporation, he could not, under the circumstances, hold them as collateral for his debt.[2] Promoters of a corporation, not representing it in any relation of agency, have no authority to enter into preliminary contracts binding the corporation, when it shall come into exist-

[1] Mr. Justice LAMAR, in Richardson's Executor *v.* Green, (1890) 133 U. S. 30; s. c., 10 Sup. Ct. Rep. 280.

[2] Ibid. Speaking for the court, Mr. Justice LAMAR said: "We do not deny that cases may arise in which, if everything were admitted to be fairly done, with the knowledge and acquiescence of the company, such a personal possession as that which Richardson obtained, although not such an actual delivery as the board had intended and directed, might be considered as equivalent to a legal delivery. But under the special circumstances of this case, in view of the unfair means employed by Richardson to have the entire body of the company's bonds transferred from the custody of Ferry [the treasurer] into his own custody, and the clandestine manner in which he took out the 400 bonds from that body, not only without notice of the fact to the company, but with an implied, if not an expressed, denial of the transactions, we do not think that he can be regarded as standing in the position of a legal and equitable pledgee, or that he ever acquired, as such pledgee, a lien on the 400 bonds. But even if there could be any doubt on this point, Richardson, himself, by his own act, has removed it. He waived and abandoned all claim to any lien, as a pledgee, by his voluntary surrender and delivery of the bonds to the sheriff of the county of New York, as the property of the company, to be sold under execution. If the 400 bonds were not delivered to Richardson, as we think the court below correctly held, it follows that the unissued bonds were not subject to attachment or to execution as valid and binding obligations against the company, and that Richardson's purchase at the sheriff's sale vested in him no title or ownership to them." See, as to the title of Richardson to these bonds, and their sale under execution, Sickles *v.* Richardson, (1881) 23 Hun, 559.

ence, and if the sanction of the corporation to such a contract is obtained by the act or co-operation of a director who has a private interest, the corporation may resist an action for specific performance, at least, in a case where it has not accepted the consideration, or taken the benefit of the contract.[1]

§ 191. Circumstances under which the directors cannot avail themselves of the defense of the invalidity of the contract.— It appeared in an action in the federal court upon a contract, that a railroad company, a corporation in form only, by its president, entered into a construction contract, whereby the contractors agreed to complete the superstructure of the road, furnish materials and equip it by a certain date, and in payment therefor certificates for a fixed amount of its full paid-up stock and the same amount of first mortgage bonds were to be delivered to them. Contemporaneously with the making of this contract, and on the same day, the contractors agreed with one acting on behalf of certain directors who were the actual stockholders, that if the contract were complied with by the company, they would pay to him one-half of the net profits realized from

[1] Munson *v.* Syracuse, Geneva & Corning R. R. Co., (1886) 103 N. Y. 58; s. c., 8 N. E. Rep. 355, affirming 29 Hun, 76; s. c., 16 N. Y. Wkly. Dig. 212. ANDREWS, J., referring to this director, said: "He stood in the attitude of selling as owner and purchasing as trustee. The law permits no one to act in such inconsistent relations. It does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case. It prevents frauds by making them, as far as may be, impossible, knowing that real motives often elude the most searching inquiry, and it leaves, neither to judge nor jury, the right to determine, upon a consideration of its advantages or disadvantages, whether a contract made under such circumstances shall stand or fall." As to contracts of officers dealing with themselves being voidable at the option of the corporation, see Meeker *v.* Winthrop Iron Co., 17 Fed. Rep. 48. In Pneumatic Gas Co. *v.* Berry, (1885) 113 U. S. 322; s. c., 5 Sup. Ct. Rep. 525, a release by the corporation to one of its directors of all claims, equitable or otherwise, arising out of transactions under a contract between the corporation and the director, made in excess of its corporate powers, was held to be valid, if made in good faith, and without fraud or concealment. As to contracts in which the interest of directors are adverse to the corporation being voidable, at the option of the corporation or, upon its refusal, by a minority of stockholders, see Graves *v.* Mono Lake Hydraulic Mining Co., (1890) 81 Cal. 303; s. c., 22 Pac. Rep. 665.

the contract, out of the stocks and bonds. The road was completed and it was agreed between the parties that the share of the directors in the net profits should be fixed at $150,000, for which the contractors were to give these notes. The latter paid $50,000 on this substituted contract, and this action was to recover of them the balance. SHIPMAN, C. J., for the United States Circuit Court of Appeals, refers to the defense made in these words: "The defense made, as a matter of law, was the invalidity of the contracts [original and substituted], because by the original contracts four directors had secretly provided for one-half of the profits which should arise out of the construction of the road, and it was claimed there could be no recovery, because the contract being void, no action could be maintained upon it or upon its successor." It was held that the principle which denounces the action of directors of a corporation who, professing to be its agents, and to be contracting in its behalf, secretly agree for a private and personal benefit to themselves, or agree to sell their official influence for personal gain, was not available as a defense by the directors in this particular case.[1]

[1] Robison *v.* McCracken, (1892) 52 Fed. Rep. 726. SHIPMAN, C. J., said: "The decisions of the courts of the United States have been most strenuous in demanding that the directors of corporations shall act disinterestedly in contracts which they make in behalf of the corporation for which they act, and in setting aside tainted contracts between a director or an agent and a third person for the sale of official influence. Wardell *v.* Railroad Co., 103 U. S. 651; Thomas *v.* Railroad Co., 109 U. S. 522; s. c., 3 Sup. Ct. Rep. 315; Woodstock Iron Co. *v.* Richmond & Danville Extension Co., 129 U. S. 643; s. c., 9 Sup. Ct. Rep. 402; West *v.* Camden, 135 U. S. 507; s. c., 10 Sup. Ct. Rep. 838; Providence Tool Co. *v.* Norris, 2 Wall. 45." The present case was there distinguished from those just cited: "It is manifest that the facts in this case are of a different character from those which have ordinarily marked contracts which are the subject of just rebuke by courts. The corporation which entered into the construction contract was one in form only, and the agreement for construction and division of the profits was, in fact, made by all the stockholders, if Mason [another of the original subscribers] was not a stockholder. But, assuming the existence of Mason's character as a stockholder, and that an exorbitant contract of the entire body of stockholders for their own pecuniary benefit can be seasonably attached [attacked ?] by existing creditors, it is well settled that, as a general rule, contracts of a corporation, which which were made by directors who obtained a personal pecuniary benefit thereby, are not, on that account alone, void, but are voidable at the election of the parties who are affected by the fraud. This is clearly announced in Barnes *v.* Brown, 80 N. Y. 527; Barr *v.* Railroad Co., 125 N. Y. 263; s. c., 26 N. E. Rep. 145; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587, and Thomas *v.* Railroad Co., 109 U. S. 522; s. c., 3 Sup. Ct. Rep. 315. In the latter case it is said, in substance, that those for whom the agent was acting have the option to avoid such a contract, but until they exercise their option, and reasonably show that it is their purpose not to submit to the act of the agent, the contract is in existence, and is not a nullity. In this case, Mason, the remaining stockholder at the time, has not dissented, but desires to enjoy the contract. The corporation has never dissented. [The contractors] to whom the whole stock was issued, made both contracts, paid $50,000 upon the [substituted] contract, the last payment being nine months after its date. Neither creditors nor the present stockholders have ever dissented. The case clearly falls within the general rule which has been cited. It contains no circumstances which create an exception, and make the contract one which is absolutely void. The condition of the defendants is this: They made a voidable contract with the plaintiff, which has not been avoided. The contract is an executed one; the defendants received and sold the entire stock and bonds of the company and have the fruits of the contract, a part of which they have paid, and the residue of which they refuse to pay, upon the ground that the contract was illegal in its relations to the corporation. Cases may arise where a court will have nothing to do with the controversies in regard to the proceeds of a business of an inherently corrupt and wicked character, but this is not one of them. The weakness of the defendants' position is clearly disclosed in McBlair *v.* Gibbes, 17 How 232; Brooks *v.* Martin, 2 Wall. 70; Planters' Bank *v.* Union Bank, 16 Wall. 483, and Railroad Co. *v.* Durant, 95 U. S. 579. In the latter case the court said: 'The appellee cannot claim adversely to those for whom he acquired and holds the property. The rights of others, if such rights exist, do not concern him. He cannot vicariously assert them.'"

§ 192. Purchase by officers of debts due by, or property of, corporations.— A director may trade with, borrow from or loan money to a corporation on the same terms and in like manner as other persons. In loaning money to the corporation, however, he must act fairly and be free from all fraud and oppression; and in so doing must act for the interest of the corporation and impose no unfair or unreasonable terms.[1] Directors may purchase the bonds issued by a corporation or other of its indebtedness in whatever form it exists. And if such bonds or indebtedness is secured by a trust deed, for instance, they have a right to proceed, if necessary, to sell the property for the satisfaction of such indebtedness as any other person.[2] If the corporation has money or property which can be converted into money with which to redeem its property from a judicial sale or from the lien of the trust deed, a purchase of the bonds or other indebtedness by directors, as a means of acquiring through a sale the property of the corporation, would be in bad faith, and a

[1] Harts *v.* Brown, (1875) 77 Ill. 226.

[2] Ibid.

purchase by them of the property under such circumstances would not be sustained.[1] And if a sale were necessary by reason of a lack of means on the part of the corporation to relieve the property from the liens and prevent a sale of property beyond the amount necessary to pay the debts secured by the trust deed, though made with the assent and by direction of the directors, and they purchase it, the sale in this respect would be void, as it would be a sale to that extent in which the directors would be the vendors, and they could not purchase of themselves.[2] A trustee of a corporation may purchase with his own funds a judgment which has been recovered against the corporation for less than the amount due thereon, and in case he assigns it to a third person, the assignee may enforce the judgment against the corporation for the full amount due upon it.[3] In case a director or trustee of a corporation seek the enforcement of a judgment against it owned by himself by a sale of the property or assets of the corporation, it would be incumbent upon him to act with the greatest fairness and publicity and to do everything reasonable within his power to secure the highest price for the property sold; and if he should be guilty of any improper conduct by which he secures to himself the property of the corporation for less than its fair market value, the sale may be set aside on the application of any of the parties interested.[1] One of the appellate courts of Missouri reversed a judgment in the court below, and held that the president of a corporation who had voluntarily purchased a small debt against the corporation should be enjoined from levying an execution for the payment of a balance on the claim where he had already taken valuable property of the corporation in part payment of it.

[1] Ibid.

[2] Ibid.

[3] Inglehart *v.* Thousand Island Hotel Co., (1884) 32 Hun, 377. The Supreme Court of New York in General Term have said upon this subject: "That a trustee of a corporation organized under the general laws of this state acts in a fiduciary character, is not a subject of doubt, as he is intrusted with power and authority to be exercised in the interest of the stockholders and creditors of the company. In dealing with its property and in the management of its affairs he is subject to the obligations and disabilities incident to that relation, and he must so act as not to permit himself or his own private interests to interfere or compete with his duty to the company. [Citing] Hoyle *v.* Plattsburgh & Montreal R. R. Co., 54 N. Y. 314; Cumberland Coal Co. *v.* Sherman, 30 Barb. 553; Twin-Lick Oil Co. v. Marbury, 91 U. S. 588. It is not, however, deemed to be inconsistent with the duties which a trustee owes a company to loan and advance to it moneys to be used in transacting its legitimate business and to meet its financial wants and receive security therefor by mortgage or pledge of the assets of the company. By fair dealing and in the legitimate business of the company he may become one of its creditors. Transactions of this character between an officer of the company and the company itself are of frequent occurrence, and have received the approval and sanction of the courts as appropriate and not inconsistent with the duty which a trustee owes to the stockholders and creditors of the company. [Citing] Duncomb *v.* N. Y., H. & N. R. R. Co., 84 N. Y. 190; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 588. So also a trustee or director may, with his own money, purchase for himself of a third person a valid and subsisting outstanding debt owing by the company and secure a perfect title thereto. Such a transaction is not even a ground for entertaining the suspicion that it is in violation of any duty which he owes the corporation, and there is no presumption of law against its fairness. If the obligation is valid the owner may sell and transfer it to any one who is willing to become a purchaser, and he thereby secures an unquestionable title. [Citing] cases *supra;* Clark *v.* Flint & Pere Marquette R. Co., 5 Hun, 556. The other question to be considered in this connection is, will the trustee or director be permitted to enforce a collection of the debt thus acquired for its entire amount, or shall he be limited to the sum which he actually paid for the debt or obligation? I am unable to discover any good reason why he should not be permitted to enforce judgment for the full amount, nor can I find any decision limiting the trustee to the sum actually paid. In these times a large proportion of the mercantile, commercial and manufacturing business of the country is carried on by corporations, and many of them issue, in large amounts, securities in the form of negotiable instruments, payable in the future, which are purchased and held as investments by capitalists and others, and it has never been questioned but that a director in a corporation of this character might purchase the same of a third person at a discount, and collect from the company the entire sum secured thereby."

[1] Inglehart *v.* Thousand Island Hotel Co., (1884) 32 Hun, 377.

[2] Brewster *v.* Stratman, (1877) 4 Mo. App. 41. Lewis, P. J., said: "The fiduciary position held by the president of a corporation does not admit of his speculating in either its assets or its indebtedness, for his own benefit, at the expense of the corporation. He is a trustee, and as such can never be permitted to create such a relation between himself and the trust property as will make his own interest necessarily and effectually antagonistic to that of his beneficiary. In Covington & Lexington Railroad Co. *v.* Bowler, 9 Bush (Ky.), 468, a director had purchased at a judicial sale the railroad belonging to his corporation. It was held, upon the principle just stated, that the corporation had a right to have its road surrendered to it upon placing the director *in statu quo.* * * * In McAllen *v.* Woodcock, a suit in ejectment, 60 Mo. 174, it was held that where, under execution against a corporation, its land was purchased by one who was a stockholder and treasurer of the company, the purchase must be regarded as having been made for the benefit of the association, and that the title thus acquired could not be considered as hostile thereto." In Lingle *v.* National Insurance Co., 45 Mo. 109, the Supreme Court of Missouri affirmed the judgment of the court below awarding out of the assets

§ 193. Purchase and sale of property of corporation by officers.— Where a sale of the property of a corporation to raise money to pay its debts may become necessary on account of the mismanagement of its affairs by the directors, and those directors for that purpose sell it to one of their number, the sale may be set aside.[1] For a sale and purchase under such circumstances to stand, it must be shown that there was a necessity for the sale and that the property of the corporation was bought by the directors in open market at a fair price and without any undue advantage, in good faith and without the slightest unfairness.[2] A director of an insolvent corporation, buying its property at a sale under execution to which he is not a party, will be liable to the corporation for the value of the property less what he may have paid for it.[3] In case directors of a corporation divert its property from the payment of its debts, by which diversion creditors may be deprived of the opportunity to enforce their debts the injured creditors may have relief through a court of equity.[4] Should such a diversion of the corporate property charged to be injurious to the creditors be a sale of such property to one of the directors taking part in the transaction as buyer and seller, the directors must establish both the good faith of the transactions and that the sale was for the full value of the property. If these

of the company to its president, upon a judgment which he had purchased against the corporation, the amount he actually paid. The court said: "At the time [appellant] purchased the judgment he was president of the company and acting for the company. The company's interest and his, in the transaction, were identical, and could not be separated. Whatever advantage he gained inured to its benefit. To permit the chief managing officer of a company in such a manner to speculate for his private gain would be detrimental to the company and the other stockholders, and would lead to fraud, injustice and wrong. Public policy and morality alike forbid that such a proceeding should be sanctioned. It is true that in ordinary cases no person would have a right to complain of the transaction but the company who suffered by the acts of its officer. But, in a case like this, the creditors whose rights are impaired should be permitted to make the objection." As to the incompetency of a director in a corporation to become the purchaser of a portion of its property, who has actively participated in all measures pending the completion of the arrangements for its sale, with full knowledge of all the circumstances attending their progress, see Hoffman Steam Coal Co. *v.* Cumberland Coal & Iron Co., 16 Md. 456.

[1] Crescent City Brewing Co. *v.* Flanner, (1892) 44 La. Ann. 22; s. c., 10 So. Rep. 384.

[2] Ibid.

[3] Tobin Canning Co. *v.* Fraser, (1891) 81 Tex. 407; s. c., 17 S. W. Rep. 25.

[4] Wilkinson *v.* Bauerle, (1887), 41 N. J. Eq. 635; s. c., 7 Atl. Rep. 514.

facts be not established the directors taking part in the sale will be held answerable to the creditors for their losses by the diversion of the corporate property.[1] Where a railroad company had become insolvent and discontinued its operations, and a director of the company had purchased certain railroad ties from the contractor furnishing them to the company, it was attempted to enforce an execution in favor of creditors of the corporation upon this property. Andrews, J., for the New York Court of Appeals, said: "Assuming that the plaintiff was disabled by the rule in equity from purchasing the ties on his own account or from holding them as against the company, nevertheless the legal title was vested in him by the purchase, and the property could not be taken from his possession under an execution against the corporation. * * * The purchase by a trustee of trust property is voidable, not void. The company could only claim the benefit of the purchase by the plaintiff on reimbursing the sum expended by him in obtaining the title."[2] A director, for instance, purchasing the lands of a corporation for one-tenth of their value, there would be raised against him a presumption of fraud, and he would be required to show affirmatively that the transaction was a perfectly fair one.[3] The Civil Code of California, section 2228, requires the highest good faith from a trustee towards his beneficiary, and section 2230 prohibits the trustee from taking part in any transaction adverse to the beneficiary. Under these sections the Supreme Court of that state has held a secretary of a corporation, at the same time its general manager, to whom all its affairs were intrusted, to have been guilty of a fraud upon the corporation in secretly purchasing its property in his own name when sold under execution or at tax sales.[4] A director may loan money to the corporation, take a mortgage to himself securing the loan, and upon foreclosure of the mortgage may purchase the property and obtain title to the property mortgaged.[5] A director

[1] Ibid.

[2] Cornell *v.* Clark, (1887) 104 N. Y. 451; s. c., 10 N. E. Rep. 888.

[3] Woodroof *v.* Howes, (1891), 88 Cal. 184; s. c., 26 Pac. Rep. 111.

[4] San Francisco Water Co. *v.* Pattee, (1890) 86 Cal. 623; s. c., 25 Pac. Rep. 135.

[5] Preston *v.* Loughran, (1890) 58 Hun, 210; s. c., 12 N. Y. Supp. 313. As to a purchase by a director of the property of a corporation at a foreclosure mortgage sale being valid, see Saltmarsh *v.* Spaulding, (1888) 147 Mass. 224; s. c., 17 N. E. Rep. 316.

of a corporation cannot, for instance, take possession of corporate property and set up his individual possession to the exclusion of the corporation of which he is an equitable trustee.[1] The directors of "a going concern," though the corporation be insolvent, will not be held liable, as for a breach of trust, for making a *bona fide* advantageous sale out and out of the corporate assets, all of which assets may have been attached, to one of the attaching creditors on condition that he would cancel his own debt and discharge the debts of other attaching creditors, especially where the directors have no means with which to control the attachment suits, and the transfer be advised by counsel.[2]

§ 194. Illustrations of a sale of property to corporation which was not fraudulent. — The corporation, upon the notes of which this action was brought in the federal court of the district of Kansas, in its answer denied the authority of the president and secretary of the company to execute or issue such notes, and further claimed that the notes were fraudulently and wrongfully issued through the collusion of the officers and directors of the company, and without any consideration whatever therefor. The facts were that two of the directors had, previously to the organization of the company, purchased a roadbed for a very small sum of money. They afterwards caused the defendant company to be organized, and, while in the relation of directors with others of the newly organized company, contracted with the other directors to sell the roadbed to the company for $200,000 cash or bonds and $3,600,000 of the capital stock. The sale was formally ratified at a meeting of the directors and entered on the records of the company; and afterwards the stockholders unanimously approved the purchase. At the time of the sale there were no stockholders, and the stock issued was all that had been subscribed. The company had no property except its charter and the roadbed, and the notes [which were issued instead of bonds] and stock issued to [the vendors] had no marketable value.

[1] Hoffman *v.* Reichert, (1889), 31 Ill. App. 558.

[2] White, Potter & Paige Mfg. Co. *v.* Henry B. Pettes Importing Co., (1887), 30 Fed. Rep. 864. That directors have no power to sell the entire movable property of a corporation used in its corporate business and disable the corporation from fulfilling the purposes for which it was created, see Abbot *v.* American Hard Rubber Co., 33 Barb. 578.

It was held that the sale was not fraudulent.[1] In a Kansas case it was attempted to make certain persons, directors of a railroad corporation, account for the profits made by them in selling to it a roadbed which they had purchased before the organization of the railroad corporation for a small sum for a much larger sum than they had paid. The Supreme Court ruled that the owners of

[1] Stewart *v.* St. Louis, Ft. S. & W. R. Co., (1887) 41 Fed. Rep. 736. FOSTER, J., discussed the actions of these directors in the premises as follows: "There is no doubt but the directors [the vendors], and perhaps [another director], while directors of the company, used their influence to consummate this sale from themselves as individuals to the company; and it is altogether probable they had that object in view when they bought the roadbed from [the vendor to them]. But the question still remains, were they guilty of fraud, deception or any other breach of good faith in their fiduciary relations as directors? At the time they bought the property the defendant company had not been organized, and at that time, of course, they could not have held any fiduciary relations to stockholders or any one else. When the sale to the company was made they did hold a position of trust, and were bound, in their official action, to faithfully and honestly execute their duties, and not to make a deal where their personal interest should be served at the expense of the company they represented. Wardell *v.* Railroad Co., 103 U. S. 651; Ryan *v.* Railroad Co., 21 Kans. 365; Koehler *v.* Iron Co., 2 Black, 715; 1 Moraw. Priv. Corp. § 517; Michaud *v.* Girod, 4 How. 513. But it does not follow that the directors are prohibited under all circumstances from dealing with a member or members of the board as individuals. But there must have been a fair open deal. It must have been free from fraud or collusion, and characterized by entire good faith." Hotel Co. *v.* Wade, 97 U. S. 13; 1 Mor. Priv. Corp. §§ 292, 521, 545; Van Cott *v.* Van Brunt, 82 N. Y. 535; Simons *v.* Oil Co., 61 Pa. St. 202; Oil Co. *v.* Densmore, 64 Pa. St. 43; Rice's Appeal, 79 Pa. St. 168; Parker *v.* Nickerson, 137 Mass. 487. The judge then discussed the particular facts of this case in these words: "It does not appear in this case that there was any deception or fraud practiced by the parties. The property was open to inspection, and the approximate cost of constructing it was easily obtainable. Its value to the company for the purpose desired was not difficult to ascertain. I find no evidence of any representations as to its value or cost, or purchase price, made by the parties selling; but there is record evidence that the board of directors several months after the sale, and with full knowledge of the transaction, formally approved and ratified it, and not only that, but subsequently, at a meeting of all the stockholders, the transaction was again ratified. Now, who were defrauded or deceived? All parties — directors and stockholders — assented to it, and surely subsequent purchasers of the stock, or the corporation itself, cannot now object to it. 1 Moraw. Priv. Corp. 290. It is true the vendors got a very large advance on the price they paid, but that is not alone the test by which the *bona fides* of the transaction is to be tried. 1 Moraw. Priv. Corp. 293. To them as individuals the property was of little or no value. To the railroad company it could be made worth the price paid

a graded roadbed could sell to a railroad corporation, the officers, directors and stockholders of which were composed of these owners, and receive in payment therefor shares in its capital stock at a time when those selling the roadbed owned and controlled the corporation, and are the absolute owners of all the stock issued by it, and where the terms of sale and the issue of the stock are matters of record on the corporation's books, and where the transaction occurs months before any other or additional stock is issued by the corporation.[1] This rule was based upon the fact that at the time of the purchase of this roadbed by the vendors of it to the corporation the corporation really had no corporate existence, and that there could not have existed any fiduciary relations between them before that time, because there was no corporation in existence to create them.[2]

§ 195. When a transfer of property of corporation will be upheld.— These facts are disclosed in a New York case. A manufacturing corporation was organized for the purpose of manufacturing carpets by machinery covered by certain letters patent, and issuing licenses for the use of the invention; its capital stock was $40,000, which was issued to the defendants, the owners of the letters patent, as the consideration for the assignment by them of the letters patent to the corporation. The actual value of the patent was much more than the sum specified, and the transfer was made without regard to its value, as a convenient mode of holding title, and for the exclusive benefit of the owners, who, as sole stockholders and trustees of the corporation, carried on the business of issuing licenses to use the inven-

for it; and the vendors bent every energy to make the property useful to the company, and to make the enterprise successful, for their chances of getting money or any other value for the property depended very largely on the result. As before remarked, parties having stock afterwards in the company cannot complain of the purchase. The records of the company show the transaction. It was not kept a secret. There was no compelling any person or municipality to take stock in the company unless they voluntarily chose to do so; and, if they were deceived by misrepresentations of the officers, their cause of action rests on that deception, and not in an attack on the original contract of purchase."

[1] St. Louis, Ft. Scott & Witchita R. R. Co. *v.* Tiernan, (1887) 37 Kans. 606; s. c., 15 Pac. Rep. 544.

[2] Ibid. There is a very full discussion of the questions relating to promoters of corporations, their rights, duties and liabilities, as viewed in English and American courts, in this case.

tion and collecting royalties. Subsequently, concluding to go into the business of manufacturing, the defendants, as trustees, transferred back to themselves the letters patent, they surrendering the stock issued to themselves as above stated. The stock of the corporation was increased to $600,000, all of which was issued to defendants, they paying first $250,000 in cash, and for the residue granting to the corporation a license to manufacture under the patent, on payment of a specified royalty. It was found by the trial court that this transaction was in good faith and with no intent to defraud any future holder of the stock, and that $350,000 of stocks was not an inadequate consideration for the license. Defendants thereafter assigned to plaintiff and another $100,000 of the stock, as the consideration of their assignment to the corporation of certain other letters patent. These assignees were informed of all the facts relating to the retransfer to defendants and the consideration for the issuing to them of the increased stock. Stock was also sold to another person who had knowledge of the facts. Plaintiff was elected a trustee. The corporation erected manufactories and carried on the business for a time, which resulted in a loss. Defendants and another, comprising a majority of the board of trustees, as such, adopted a resolution to sell the stock on hand, lease the manufactories, and to secure defendants for advances made by them by mortgage on the property of the corporation which was executed with the assent of two-thirds in interest of the stockholders. Defendants were the only creditors of the corporation, and the trial court found that the resolution above referred to was adopted in good faith, without intent to injure, and that it did not affect plaintiff, and was for the best interests of the corporation and its stockholders. The mortgage was thereafter foreclosed and the property bought in by one of the defendants. Plaintiff brought his action as trustee of the corporation to set aside the transfers of its property, which he alleged had been made or authorized by the defendant trustees as such to themselves individually, and for an accounting. The Court of Appeals of New York, upon the facts stated above, held that the complaint was properly dismissed.[1]

[1] Skinner *v.* Smith, (1892) 134 N. Y. 240, affirming 56 Hun, 437. The court said: "A contract entered into by a corporation by the authority or direction of its trustees, with themselves and for their benefit, or a transfer of its property by the authority of the trustees to themselves, may be set aside, in case it injures any public interest, or the private interest of any

§ 196. Officers voting themselves salaries or compensation.—The vote of a director for his own salary is manifestly illegal.[1] An agreement of directors to pay themselves a stipulated sum for services in the employment of a corporation is void.[2] The salary of the president of a corporation having been fixed by its directors, as they have a right to do, and accepting the office under their action, he cannot, by his vote as a director, increase his salary.[3] Where the superintendent of a corporation is also a director, his compensation must be fixed by corporate action, a record of which should be made upon the books of the corporation.[4] Should directors, who are not entitled to compensation for their services as directors by the provisions of the charter of the corporation or by its by-laws, or some custom or usage allowing such compensation, make such allowance to themselves for past services and issue bonds or orders for such allowances, their acts will be void and of no effect.[5] Salaries voted by its board of directors to one or more of their number, who are present and participating in the action, are not binding upon a corporation.[6] Where

shareholder or creditor, even though the contract or transfer was executed in good faith by the trustees. Duncomb *v.* N. Y., H. & N. R. R. Co., 84 N. Y. 190. But this rule is not broad enough to condemn as void on the ground of public policy all contracts and transfers executed by a purely private business corporation, with or to its trustees, in good faith, in case no public or private interest is harmed thereby. Such contracts are not void, but voidable, at the election of those who are affected by the fraud. Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587–589; Thomas *v.* Brownville, etc., R. R. Co., 109 U. S. 522–524; Risley *v.* Indianapolis, B. & W. R. R. Co., 62 N. Y. 240; Barnes *v.* Brown, 80 N. Y. 527–536; Munson *v.* S., G. & C. R. R. Co., 103 N. Y. 58–73; Barr *v.* N. Y., L. E. & W. R. R. Co., 125 N. Y. 263–277." The court, in the opinion in this case, concluded with this statement: "The right of a manufacturing corporation to discontinue its operations when they have become unprofitable, for the purpose of protecting shareholders from further loss, does not admit, we think, of doubt. Treadwell *v.* Salisbury Mfg. Co., 7 Gray, 395." Hancock *v.* Holbrook, 9 Fed. Rep. 353; Boston & P. R. R. Co. *v.* N. Y. & N. E. R. R. Co., 13 R. I. 263; Buford *v.* Keokuk L. Packet Co., 69 Mo. 611; Morawetz Corp., §§ 413 *et seq.* 1004.

[1] Davis Mill Co. *v.* Bennett, (1889) 39 Mo. App. 460.

[2] Guiid *v.* Parker, 43 N. J. Law, 430.

[3] Ward *v.* Davidson, (1886) 89 Mo. 445.

[4] Besch *v.* West. Carriage Manufacturing Co., (1889) 36 Mo. App. 333.

[5] Maux Ferry Gravel Road Co. *v.* Branegan, (1872) 40 Ind. 361.

[6] Kelsey *v.* Sargent, (1886) 40 Hun, 150. In Copeland *v.* Johnson Manufacturing Co., (1888) 47 Hun, 235, the contracts made between one who was president and one of the trustees of the corporation, and two of the other four trustees of the corporation, for the payment to him of fixed compensation for the performance of services rendered by him for the corporation, being dependent for their validity upon his vote, together with that of the two directors, were held to be illegal. See, also, Coleman *v.* Second Avenue R. R. Co., 38 N. Y. 201.

a board of directors had assigned to one of their number the performance of the duties of treasurer of the corporation, and no salary had been fixed for such office by the board, the Illinois Supreme Court assumed that the board chose to regard his services in that capacity as a part of his duty as director, and held that he could not recover an allowance made by them to him for such services.[1] The directors of a corporation occupying a fiduciary relation to it, should they vote themselves an excessive compensation for services in disposing of its stock, such an act would be an actual, not merely a constructive fraud.[2] In a case where the treasurer of a corporation had appropriated corporate funds to his own use as for a salary, and the court found the amount was excessive, the money was held to have been obtained by fraud and the treasurer liable for interest on the sum that he had thus appropriated.[3] In a case before the Supreme Court of New

[1] Holder *v.* LaFayette, Bloomington & Mississippi Ry. Co., (1873) 71 Ill. 106. It was said by the court: "[These directors] are managing a fund as trustees for the stockholders; and they have no right to use or appropriate the funds of their *cestuis que trust* to themselves. They have no power to waste, destroy, give away or misapply it, and when they were elected by the shareholders, no provision having been made for their compensation, the stockholders had a right to suppose they were acting under the common-law rule, that, as trustees, they could not claim payment for their services." See Kirkpatrick *v.* Penrose Ferry Bridge Co., 49 Pa. St. 121; Loan Association *v.* Stonemetz, 29 Pa. St. 534; New York & N. H. R. R. Co. *v.* Ketchum, 27 Conn. 170; Henry *v.* Rutland & B. R. R. Co., 27 Vt. 435; Butts *v.* Wood, 37 N. Y. 317; Merrick *v.* Peru Coal Co., 61 Ill. 472; Rockford, Rock Island & St. Louis R. R. Co. *v.* Sage, 65 Ill. 328; Cheeney *v.* LaFayette, Bloomington & Western Ry. Co., 68 Ill. 570; American Central R. R. Co. *v.* Miles, 52 Ill. 174; Gridley *v.* LaFayette, B. & M. Ry. Co., 71 Ill. 200; LaFayette, B. & M. Ry. Co. *v* Cheeney, 87 Ill. 446; Illinois Linen Co. *v.* Hough, 91 Ill. 63.

[2] Freeman *v.* Stine, (Pa.) 38 Leg. Int. 268; Fareira *v.* Riter, (Pa.) 38 Leg. Int. 450.

[3] Wayne Pike Co. *v.* Hammons, (1891) 129 Ind. 368; s. c., 27 N. E. Rep. 487. In Emporium Real Estate & Manufacturing Co. *v.* Emrie, (1870) 54 Ill. 345, it was held that the president of the corporation, who, claiming that the corporation was indebted to him for his salary as president and for services as attorney at law, had caused the secretary of the corporation to assign to him certain certificates of purchase of land held by the corporation, and in their possession as officers, should surrender these certificates to the corporation. It was said

York these facts were shown: That the corporation had been managed by the owners of the stock in harmony and at a small salary until the president of the corporation wanted a part of the plaintiff's stock; to compel the sale a threat was made to raise the salaries of the officers. A subsequent raise of the salaries followed. Again there was the same refusal to sell, another similar threat, and this was followed by an extremely large increase, and this was followed by a threat that there must be another increase accompanied by an averment that there was no limit to the raise except the will of the trustees. The court held that the action of the trustees in the matter of raising the salaries of its officers was a spoliation of the corporation for an unworthy purpose, and trustees would not be permitted to act in such a manner with the corporation's funds.[1] A majority of the directors, there being three, and all stockholders of a corporation, having combined, so managed the business of the corporation as to divert all the profits of the enterprise from their legitimate destination, and to appropriate them to their own use, as by voting to themselves extraordinary salaries, the chancellor held that as they had in part executed their plan, and the circumstances rendered any change in the *personnel* of the management impracticable, a proper case had arisen for the intervention of the court to make a division of the assets. He also held that such a

by the court: "The claim of the president had not been allowed by the board of directors or by a committee appointed by them. In effect, the president audited his own demand, and then seized upon property for its payment. This can never be permitted to the officers of corporations. The toleration of such practice would be destructive of the rights of creditors and of stockholders. The assets would be at the mercy of the officers, who have no legal or equitable rights to control them, except for the benefit of the company." In Ashley *v.* Kinnan, (Sup. Court, Spl. Term, 1888) 2 N. Y. Supp. 574, it was held that the amount received by an officer presiding over the board of trustees, when the board voted him a salary for certain services, and it not appearing that he dissented to this action, could be recovered of him by the receiver of the corporation on the general ground of equity controlling the actions of directors or officers of a corporation as holding a fiduciary position in connection with voting or granting anything to their personal advantage. As to the action of three of five directors of a corporation in voting a salary to one of the three as secretary being void, see Martin *v.* Santa Cruz Water Storage Co., (Ariz. 1894) 36 Pac. Rep. 36.

[1] Ziegler *v.* Hoagland, (1889) 52 Hun, 385; s. c., 5 N. Y. Supp. 305, affirming the judgment restraining such conduct on the part of the trustees, citing to the point Butts *v.* Wood, 37 N. Y. 317; Ogden *v.* Murray, 39 N. Y. 202.

trustee, having committed a breach of trust by deliberately extracting and appropriating to his own use a portion of the trust fund, could not cure the breach and demand the further custody of the fund by simply restoring it.[1]

§ 197. Interest upon exorbitant salary voted officer recoverable.— There was a contention in an Indiana case that the damages assessed by the court were too large. It was based upon the fact that the court allowed interest on the amount, or a portion of the amount, appropriated or used by the appellants. The argument was that the money received by the treasurer belonged to him and that he had the right to use it so long as he furnished the amount due when called upon to do so. The Supreme Court said of this: "The argument is based upon false premises. The treasurer of a private corporation does not bear that relation to the funds which come into his hands sustained by a public officer. A public officer, when called upon to account for moneys which come into his hands, as such, cannot excuse himself on the ground that the funds have been stolen, or destroyed without his fault, because, by legal fiction, the money is supposed to belong to him, and he must bear the loss. Such fiction is thought to be necessary for the safety of the public funds. But it is not so with the treasurer, or agent, of a private corporation. If the funds in his hands are lost, or destroyed, without his fault, the loss is the loss of the principal and not the loss of the treasurer or agent. Mowbray *v.* Antrim, 123 Ind. 24. A large portion of funds involved in this suit was allowed to the secretary and treasurer, as salary, and presumably he used the sum so allowed him. The court found that such salary was exorbitant and unreasonable and required the appellants to account for all the funds used in that way over and above a reasonable compensation for the services of the secretary and treasurer. If these funds were so used, we know of no good reason why those who used them should not account for the interest. We do not think the court erred in charging the appellants with interest on the funds which came into their hands, and which were used by the secretary and treasurer in his private business, under the guise of an exorbitant salary."[2]

[1] Fougeray *v.* Cord, (1892) 50 N. J. Eq. 185; s. c., 24 Atl. Rep. 499.

[1] Wayne Pike Company *v.* Hammons, (1891) 129 Ind. 366, 378, 379.

§ 198. Contracts between corporations having the same directors in part.— Where the managers of a railroad corporation, acting in its interests, buy a controlling interest in the stock of a connecting railroad for the purpose of making with themselves as controlling managers of the connecting road contracts more favorable to the former, and accomplish their purpose, the question whether the contracts are fair and just is immaterial in a stockholder's injunction suit to restrain the execution of the contracts.[1] A construction company contracted with a railway

[1] Pearson *v.* Concord Railroad Corporation, (1883) 62 N. H. 537. It was said by the court, in the opinion: "A director of a railroad corporation, though not technically a trustee, stands in a fiduciary relation to the corporation, and is under the disability of a trustee. Practically, the directors are trustees, and the stockholders are the *cestuis que trust*. Like all other persons where this relation exists, he cannot, as buyer for his corporation, buy of himself against the objection of his *cestui que trust*, nor as seller for the corporation become the purchaser, nor, being its agent and trustee, contract with himself or secure to himself advantages not common to other stockholders, because such contracts and relations are likely to bring him in conflict with his duty and self-interest, and tempt him to be unfaithful to the superior obligations he has assumed. [Citing] Pierce on Railroads, 36; Moraw. on Corp., § 215; Ang. & Ames on Corp. § 233, note *a*, § 312; Butts *v.* Wood, 37 N. Y. 317; Hoyle *v.* Railroad, 54 N. Y. 315, 328; Blake *v.* Railroad, 56 N. Y. 485, 490; Barnes *v.* Brown, 80 N. Y. 527, 535; Duncomb *v.* Railroad, 84 N. Y. 190, 198; Robinson *v.* Smith, 3 Paige, 222, 232; Koehler *v.* Iron Company, 2 Black, 715, 721; Bliss *v.* Matteson, 45 N. Y. 22; 1 Per. Tr. § 207; Booth *v.* Robinson, 55 Md. 419, 436, 440. * * * In England parliament has declared by statute (8 & 9 Vict. chap. 16) that no person interested in any contract with a corporation shall be capable of being a director thereof, and if any director shall directly or indirectly be concerned in any contract with the corporation, his office shall become vacant. The office becomes vacant, although in a suit at law between the parties upon such a contract the contract is not held void. Foster *v.* Railway Co., 13 C. B. 200. Such contracts are voidable in equity at the suit of a stockholder. We have no such statute; but reason and common sense, and all the analogies of the law, forbid that a person should act in a position of trust when self-interest conflicts with duty. The consciences of men in such positions will not stand the strain of self-interest. We approve the remarks of WELCH, J., in Goodin *v.* Canal Co., 18 Ohio St. 169: 'A director whose personal interests are adverse to those of the corporation has no right to be or act as a director. As soon as he finds that he has personal interests which are in conflict with those of the company, he ought to resign. No matter if a majority of the stockholders as well as himself have personal interests in conflict with those of the company. He does not represent them as persons, or represent their personal interest. He represents them as stockholders, and their interests as such.' Rolling Stock Co. *v.* Railroad, 34 Ohio St. 465, was a stockholders' bill for an injunction. The plaintiff's board of five directors were members of the defendant's board of thirteen. The bill was dismissed because not seasonably brought; and the remarks of the court, to the effect that the agreements ought to be set aside was valid because executed by a majority of the board without the interested directors, would seem to be *dicta*. Ashhurst's Appeal, 60 Pa. St. 291, and Watts' Appeal, 78 Pa. St. 370. are sometimes cited to the point that contracts or sales, made by a board of directors with or to some of their number, may be sustained in equity, and the remarks of the court are to the point that such contracts and sales may be upheld if their perfect fairness is shown. These cases were stockholders' bills to set aside sales of property, upon the ground of a violation of fiduciary duty. Relief was denied upon the ground that the applications came too late. Flagg *v.* Railway Co, 20 Blatch. 142; s. c., 21 Am. Law Reg. 775, decides that where an agreement is made by the directors relinquishing the right to a guaranty of dividends to a corporation by another corporation, the execution of the agreement will not be enjoined at the suit of a stockholder, because three of the directors voting were also stockholders in the guarantor corporation, it appearing that, without counting their votes, a majority of the directors voted for the measure. In Butts *v.* Wood, 38 Barb. 181; s. c., [on appeal] 37 N. Y. 317, the action of the majority of two in a board of three, passing upon the claim of a third director, who also voted, was set aside at the instance of one of the stockholders. See, also, Wardens of St. James *v.* Rector, etc., Church of the Redeemer, 45 Barb. 356; Kitchen *v.* Railroad, 69 Mo. 224; Railroad *v.* Kelly, 77 Ill. 426; Koehler *v.* Black, etc., Iron Co., 2 Black, 720; Moraw. on Corp. 245, and cases; 1 Perry on Tr. § 207, and cases; Pierce on Railroads, 36–40, and cases; Green Brice Ultra Vir. 477, note (a) and cases. Stockholders and creditors are entitled not only to the vote of a director in the board but to his influence and argument in discussion. Ogden *v.* Murray, 39 N. Y. 202, 207; Railway Co. *v.* Blakie, 1 Macq. (H. L. Cas.) 461, where the court said: 'It was Mr. Blakie's duty to give his co-directors, and through them to the company, the full benefit of all the knowledge and skill which he could bring to bear on the subject.' In Barnes *v.* Brown, 80 N. Y. 527, 536, the court said: 'If he [plaintiff] had attempted to perform the contract while he was director, the stockholders could probably have intervened by some suit in equity adapted to the nature of the case to nullify the contract as to him, or to restrain him as to the performance thereof, or to compel him to elect to resign his office of director, or to give up the contract.' Our conclusion upon this part of the case is, that the directors of the Concord could not make the contracts with the upper companies, nor settle the claims of those companies against the Concord. For the transaction of that part of the business of their office they were disabled by the understanding on which, the purpose for which, and the interest in and by which, they were elected."

corporation for the construction of a portion of its road, the payment to be made in the mortgage bonds of the latter. Two of the directors of the railway corporation were also parties in the construction contract. The other parties in the construction contract agreed to assume the subscriptions of all the individual directors of the railway corporation to the capital stock of that

corporation (which was worthless) and relieve the directors from all liability under it. This contract the Supreme Court of the United States held not to be enforceable in equity when resisted by stockholders in the railway corporation; and the bonds issued under it to the construction company were held to be voidable at the election of the parties affected by the fraud, while in the hands of parties who took them from the construction company, not in the ordinary course of business, but under circumstances which threw doubt upon their being holders for value or without notice.[1] The stockholders had been allowed to come into the suit for foreclosure of the mortgage and filed their cross-bill. The court said: "In this condition of the case they are amenable to the rule that they who seek equity must do equity. It is just that they should pay a fair price for what they have received; that this mortgage, given for the construction of the road, though excessive by reason of the fraud in the contract, should stand for the reasonable value of what the company actually received in the way of construction. To permit these intervenors to defeat the mortgage on any other ground would be unjust, and would make the court the instrument of this injustice."[2] In a leading Missouri case, where a railroad corporation was not in financial condition to complete its road in all its branches, which was essential to its proving profitable, an association of capitalists was formed, the object of which, as expressed in its articles, was the purchase of the bonds of the corporation, and ultimately, if found profitable to do so, the purchase of the road itself, provided the association could obtain control of the company. The bonds of the corporation were subsequently purchased of it, and the association allowed to name a majority of the directors. It was insisted that this transaction was fraudulent by reason of the

[1] Thomas, Trustee, *v.* Brownville, Fort Kearney & Pacific R. R. Co., (1883) 109 U. S. 522; s. c., 3 Sup. Ct. Rep. 315. The court said: "In the present case the stockholders of the corporation, whose officers accepted those benefits at the hands of the parties with whom they were, in the name of the corporation, making a contract for over a million of dollars, do denounce and repudiate that contract. The conduct of these directors is utterly indefensible." Referring to Wardell *v.* Union Pacific R. R. Co., 103 U. S. 651, and same case in 4 Dill. 330, as in precise analogy to this.

[2] Thomas, Trustee, *v.* Brownville, Fort Kearney & Pacific R. R. Co., (1883) 109 U. S. 522; s. c., 3 Sup. Ct. Rep. 315. As to the effect of a railway corporation and a construction company having mainly the same officers, see Davidson *v.* Mexican National R. Co., 58 Fed. Rep. 653.

control of the corporation being surrendered to the association, and because the latter looked to the ultimate acquisition of the road. These facts were held not to establish fraud.[1] It was also insisted in this case that the transaction was fraudulent because, at the time of its consummation, three of the thirteen directors of the railroad corporation were members of the association purchasing. The court held that this, if a fact, would not make the sale void.[2] The fact that shortly after the contract for purchase of bonds, etc., was proposed to the railroad corporation, and before its acceptance, several of the directors became members of the association was held to render the contract, when made, voidable only, and not absolutely void.[3] It was further held in this

[1] Kitchen *v.* St. Louis, Kansas City & Northern Ry. Co., (1878) 69 Mo. 224. The court said: "There is nothing inconsistent with the utmost good faith in either of these stipulations [as to purchase of the road or securing control of it]. The last might well have been insisted on because the purchase of the bonds, if made, involved and would require millions of money, and the only security which could be relied upon to save harmless those who furnished it, would be a faithful and honest application of it to the completion and equipment of the road. Hence, there was a propriety in the demand of these capitalists that they should have a controlling voice in the directory in order that the money furnished might be thus applied and result in giving them ample security for their investment in the bonds. So, in regard to the first stipulation, 'to buy the road ultimately, if deemed profitable to do so,' it may be said that there was nothing illegal or fraudulent in that alone, as we cannot presume and infer from it, that if they should purchase they would purchase it in any other than a lawful manner and under circumstances which would authorize them to buy."

[2] Kitchen *v.* St. Louis, Kansas City & Northern Ry. Co., (1878) 69 Mo. 224; citing, as authority, Buell *v.* Buckingham, 16 Iowa, 284; Hartridge *v.* Rockwell, R. M. Charlton's Rep. 260; Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 587.

[3] Kitchen *v.* St. Louis, Kansas City & Northern Ry. Co., (1878) 69 Mo. 224. The court said, *arguendo*, leading up to the conclusion stated in the text: "Viewing the transaction as one under which the Missouri Railroad Company was to receive sufficient money to complete the road, as therein stipulated, and pay the interest on the first mortgage bonds and save the road from sale, we have the highest authority for saying that it was not void, as is contended by plaintiffs. In the case of the Twin-Lick Oil Co. *v.* Marbury, 91 U. S. 588, which is a recently and thoroughly considered case, the court, after recognizing to the fullest extent that a director of a corporation occupying a fiduciary relation in his dealings with the subject-matter of his trust or agency, and with the beneficiary whose property is confided to his care, is viewed with jealousy, and that his acts may be set aside on slight grounds, declares 'that the general doctrine in regard to contracts of this class is not that they are absolutely void, but that they are voidable on the election of the party whose interest

case that the stockholders in meeting, having had this proposition made to them for the purchase of the bonds and obtaining control of the road, etc., submitted to them and making no objections, it was too late, after the lapse of five years, for them to impeach the transaction.[1] The mere fact that the president of a railroad company, unknown to the other directors, is interested in a construction contract let by the company would not make the contract void if it be otherwise free from fraud.[2]

§ 199. **Issue of worthless, or overissue of, stock.**— Directors issuing spurious, worthless stock would perpetrate a wrong upon the corporation and its stockholders, and a fraud upon every one who might take it as fully paid-up stock, relying upon the appearances and deceived thereby.[3] In case an attempted organization by failure to comply with the statute for organizing corporations of its kind does not become a corporation *de jure*, and cannot legally issue stock, the issue of stock by it will not alone make the directors liable for a fraudulent conspiracy to issue worthless stock.[4] Neither can an intent to deceive on the part of the directors be inferred from such issue of worthless stock, and the fact that the nominal is largely in excess of the actual capital.[5] One who had purchased shares of stock of a corporation, the managing officers of which, president, vice-president and director and treasurer, had made an overissue of stock for a large amount

has been so represented by the party claiming under it. While it is true that a director of a corporation is bound by all those rules of conscientious fairness which courts of equity have imposed as guides for dealing in such cases, it cannot be maintained that any rule forbids one director among several from loaning money to the corporation when the money is needed and the transaction is open and otherwise free from blame. * * * No adjudged case has gone so far as this. Such a doctrine, while it would afford but little protection to the corporation against actual fraud, would deprive it of the aid of those most interested in giving aid and best qualified to judge of the necessity of that aid and the extent to which it might be given.' The same doctrine was, in the strongest terms, announced in Judge RYLAND'S opinion in the case of The City & County of St. Louis *v.* Alexander, 23 Mo. 528, and the authorities cited, upon which the opinion is based."

[1] Kitchen *v.* St. Louis, Kansas City & Northern Ry. Co., (1878) 69 Mo. 224.

[2] Augusta, Tallahassee & Gulf R. Co. *v.* Kittel, (1892) 52 Fed. Rep. 63.

[3] Barnes *v.* Brown, (1880) 80 N. Y. 527, 534; citing Mechanics' Bank *v.* New York & New Haven R. R. Co., 13 N. Y. 599; Bruff *v.* Mali, 36 N. Y. 200; Morgan *v.* Skiddy, 62 N. Y. 319; Shotwell *v.* Mali, 38 Barb. 445.

[4] Nelson *v.* Luling, (1875) 62 N. Y. 645.

[5] Ibid.

and converted the proceeds to their own use, was held to have stated a good cause of action in his complaint against those officers in alleging the above facts, and the further allegation that by the overissue of stock the genuine stock, including that held by himself, was rendered valueless and became unsalable.[1] Officers of a corporation issuing false certificates of stock authenticated by them as genuine and placed by them on the market with fraudulent intent, are liable to every holder into whose hands they may come by fair purchase.[2] In a Vermont case, where the treasurer of the corporation had fraudulently overissued stock of the corporation and sold the same for money, it was held that the corporation might recover in general assumpsit from him the money he had received for such stock, where the spurious stock had become so intermingled with the genuine as to be indistinguishable and the corporation had been compelled to and had treated it as genuine.[3] Further, that, although the stock, when issued, may have been absolutely void, and the issuing of it by the treasurer a crime, the treasurer could not allege the illegality of his act as a reason why he should not pay over the money.[4]

[1] Cazeaux *v.* Mali, (1857) 25 Barb. 578; s. c., as Mead *v.* Mali, 15 How. Pr. 347. See, also, Wells *v.* Jewett, 11 How. Pr. 242; Bell *v.* Mali, 11 How. Pr. 254.

[2] Bruff *v.* Mali, (1867) 36 N. Y. 200; Seiser *v.* Mali, 6 Abb. Pr. 270, *note;* Shotwell *v.* Mali, 38 Barb. 445. For a case illustrating under what circumstances the purchasers of stock endangered thereby would not have a remedy in equity against the fraudulently acting directors, see Morrison *v.* Globe Panorama Co., 28 Fed. Rep. 817. Fraudulent issue of stock: Clark *v.* American Coal Co., (Iowa, 1894) 53 N. W. Rep. 291; Citizens' Nat. Bank of Cincinnati *v.* Cincinnati, N. O. & T. R. Ry. Co., 29 Wkly. Law Bull. 15; Brown *v.* Duluth, M. & N. Ry. Co., 53 Fed. Rep. 889; Florida Land & Imp. Co. *v.* Merrill, 52 Fed. Rep. 77; s. c., 2 C. C. A. 629.

[3] Rutland Railroad Co. *v.* Haven, (1889) 62 Vt. 39; s. c., 19 Atl. Rep. 769.

[4] Ibid. In Wright's Appeal, (1882) 99 Pa. St. 425, the president of a railway corporation, it appeared, induced a stockholder in the corporation to surrender to him her shares of stock, together with blank powers of attorney to transfer the same, by means of false representations that they were needed to aid the corporation. He gave to her his individual due bill, transferred the stock and embezzled the proceeds. Subsequently, by combination with other officers, he fraudulently issued stock in excess of the charter limit, and of this overissue of stock he awarded to the use from whence he had secured the shares which he transferred a number of shares equal to the number of her voted shares. In an equity proceeding by her to determine her rights and the corporation's growing out of this transaction, the Supreme Court of Pennsylvania held that she must bear the loss resulting from the embezzlement by the president of the funds re-

§ 200. False representations of officers — deceit. — The directors of a corporation are personally liable to persons who may sustain loss in consequence of false representations made by the directors to them or to the public at large, such representations being fraudulently and designedly made, or ignorantly made, concerning facts susceptible of knowledge, and of which it is the official duty of the directors to obtain correct information.[1] A stockholder in this Texas case had been induced by the representations of these directors to deposit money with the company, which was then insolvent, and these directors had accepted the deposits and applied them to the payment of a debt for which they were sureties. The court held that the directors were estopped in this action to charge them personally to set up as a defense their want of authority to receive the deposits.[2] It was further held that the fact that the plaintiff was a stockholder and had access to the books of the concern, and the means of knowing its true condition would not, of itself, prevent a recovery against the directors.[3] Persons representing to the public that a corporation had been regularly organized, in circulars signed by them as regularly elected officers, and prematurely issuing stock certificates, one purchasing such certificates will be entitled to recover damages for his injury, the result of such purchase, irrespective of any intent on their part to defraud him in particular.[4] In an action against the directors of an insurance

sulting from a sale of her valid shares, and that the shares he issued to her in excess of the charter limit were invalid and valueless. The ground was that, under the facts of the case, the president was acting as her agent and not as agent for the corporation. For another case involving the fraudulent issue of stock by this president of this railroad corporation, see Mount Holly Paper Co.'s Appeal, (1882) 12 W. N. C. (Pa.) 228.

[1] Kinkler *v.* Junica, (1892) 84 Tex. 116; s. c., 19 S. W. Rep. 359, adhering to Seale *v.* Baker, 70 Tex. 286; s. c., 7 S. W. Rep. 742.

[2] Kinkler *v.* Junica, (1892) 84 Tex. 116; s. c., 19 S. W. Rep. 359.

[3] Ibid. The court said: "A stockholder in a corporation has as much right to protection against the fraudulent acts of the trustees or directors as any one else, if, indeed, he has not more right, although on account of his access to the books, he may be held to greater care in his dealings with the corporation." As to what would be proper instructions to the jury in an action of deceit to charge a president of a corporation with the debt of the corporation by reason of his representations to a creditor as to the solvency of the corporation, see King *v.* Davis, (1891) 61 Hun, 627; s. c., 16 N. Y. Supp. 427.

[4] Fenn *v.* Curtis, (1881) 23 Hun, 384.

corporation for damages incurred by one who had been induced by a statement made by its officers as to its assets, to insure his property, and had met with a loss, which, by reason of the utter insolvency of the corporation, he was unable to make good out of the corporation, based upon the misfeasance of the directors in fraudulently permitting such statement to be made, one of the defendants denied his participation in the fraud, and all knowledge that certain bonds belonging to him were represented in the official published statement as property of the company. The Supreme Court of Connecticut held that evidence was admissible on the part of the plaintiff to show that the president and another director of the corporation had, shortly before the publication of the statement, solicited the director denying his liability to make some arrangement by which the bonds could be represented to be the property of the corporation; also, that a receipt given by him to the corporation, acknowledging that the bonds were the property of the corporation, and were held by him subject to its order, was admissible; further, that his acts after the plaintiff had taken his policy, not in themselves independent, but connected with and growing out of the previous fraudulent purpose, were admissible to show his knowledge of, and participation in, the fraud.[1] The United States Supreme Court affirmed the sustaining of a demurrer to a bill filed by bondholders against the president of a railroad corporation and others, to make him liable to them on allegations of fraudulent representations on his part as to the length of the road, a mortgage on which was to be a part of the security for the payment of the bonds, and for fraudulently allowing a misapplication of the moneys realized upon the sale of the bonds to them, etc. They held that the allegation in the bill that the president received money from the sale of the bonds, but not averring that the bondholders had obtained judgment against the corporation upon their bonds, and that execution issued on the judgment against the corporation had been returned *nulla bona*, showed nothing entitling the bondholders to relief in equity as a creditor of the corporation; further, that the president of such a corporation held no fiduciary relation to the bondholders of the corporation which required him, as their trustee or agent, to see to the

[1] Salmon *v.* Richardson, (1862) 30 Conn. 360.

proper application of the moneys received by the corporation from the sale of the bonds, or to account to the bondholders for any surplus from the proceeds of their bonds after constructing the works for which they were issued; that his fiduciary relations and duties in these respects were to the corporation and its stockholders, and not to the creditors of the corporation; that the representations made in the circular issued under his name were the representations of the corporation, and in no respect his personal representations.[1] The president of a manufacturing corporation writing to induce one to purchase, and pay in cash for it $10,000, value of its stock at par, offered a position for her son, and represented to her by letter that the corporation was in a flourishing condition, and that there had been paid a dividend of seven per cent upon the stock, as she reasonably understood the letter, nine months before, when in fact it was paid one year before that date. This was three months before the close of a fiscal year, and when that period of time was reached, she expected a dividend, but was informed that the condition of the corporation was such that the managers had deemed it best to withhold declaring a dividend. This president, it afterwards, in her action by bill in equity, developed, had sold certain recipes and good will, etc., for manufacturing the articles which they manufactured, which were utterly worthless, and for which he had been paid largely out of the money she paid in for stock purchased under the inducements he had held out to her, and upon his representations. Her bill was filed against the corporation and the president for recovery, account, etc., to have the assets of the corporation, in so far as they would be available to her claim, for the amount of money she had, in the mode proposed to her, contributed to the corporation, and for general relief for the deficiency against the president on account of his fraudulent representations and wrongdoings in the management of the corporation's finances in his own interest by which she was damaged. It was contended, before the Supreme Court of the United States, that the court had no jurisdiction in equity, as against him. The court sustained its jurisdiction on the various grounds of equity as shown in the allegations of the bill, and the findings as to the facts, and affirmed the decree in her favor for the deficiency against the president of the corporation individu-

[1] Van Weel *v.* Winston, (1885) 115 U. S. 228; s. c., 6 Sup. Ct. Rep. 22.

ally.[1] An officer of a corporation making false statements with reference to the financial status of the corporation, and thereby inducing an exchange of property by another, for such stock, would be liable to the latter in a personal action for the damages caused to him by the transaction.[2] This would be true even if the false statement be made by the officers in a statement as to the resources and liabilities of the corporation, required by statute, if such statement is relied upon in purchasing the stock.[3] Where several persons engage in business jointly, and, to facilitate such business, use a corporate name and issue stock, and, in the promotion of the scheme, false representations are made by those holding themselves out as promoters and managers of the business, as to the material facts of inducement and as to matters peculiarly within the knowledge of all the associates or their agents, all those engaged in the promotion of the business, as associates of those making the false representations, are liable to those who, relying upon such representations, purchase stock to their cost and injury.[4]

[1] Tyler *v.* Savage, (1892) 143 U. S. 79; s. c., 12 Sup. Ct. Rep. 340. Mr. Justice BLATCHFORD, referring especially to the statement as to the prior declaration of a dividend, in his letter to complainant, said: "This suppression of a material fact [the date when the dividend was actually declared] which Tyler [the president] was bound in good faith to disclose, was equivalent to a false representation. Stewart *v.* Wyoming Ranche Co., 128 U. S. 383, 388. The effect of the fraud committed by Tyler inured directly to his personal advantage. Not only was he, as a large stockholder and salaried officer, benefited by the plaintiff's payment into the treasury of the company of the $10,000, but, as already shown, $6,200 of that sum went directly to his benefit, and the remainder, he testifies, went to the purchase of material and ordinary expenses of the company. The latter amount enabled the company to continue paying to Tyler his salary for some time longer."

[2] Newbery *v.* Garland, (1860) 31 Barb. 121. See, also, Bagshaw *v.* Seymour, 4 C. B. (N. S.) 873.

[3] Morse *v.* Swits, 19 How. Pr. 275.

[4] Hornblower *v.* Crandall, (1879) 7 Mo. App. 220; affirmed in Hornblower *v.* Crandall, (1883) 78 Mo. 581. It was said in Hornblower *v.* Crandall, 7 Mo. App. 220, 232: "The doctrine by which the defendants are here made liable is a well-settled doctrine. Persons investing in stock, under circumstances like the present, have a right to confide in those who hold themselves out as the promoters and managers of a business which they are carrying on, so far as concerns representations made by such promoters, or under their authority, as to material facts of inducement peculiarly within the knowledge of the associates or their agents." Citing Cross *v.* Sackett, 2 Bosw. 617; Cazeaux *v.* Mali, 25 Barb. 583; Simons *v.* Vulcan, etc., Co., 61 Pa. St. 202; Morgan *v.* Skiddy, 62 N. Y. 319; Miller *v.* Barber, 66 N. Y. 558; Bradley *v.* Poole, 98 Mass. 169; New, etc., Co. *v.* Erlanger, 4 Cent. L. J. 510.

§ 201. A leading English decision on this subject.— In a comparatively late English case, an action of deceit brought by a shareholder against the directors of a tramway company, based upon statements in a prospectus which they issued, which induced him to purchase his shares, it appeared that the company was incorporated with the right to move their carriages by animal power, and, with the consent of the board of trade of the city, by steam power. It was stated in the prospectus that the company had the right to use steam power instead of horses. On the faith of this statement the plaintiff purchased his shares. The board of trade afterwards refused their consent to the use of steam power and the company was wound up. The justice before whom the action was first tried gave a decision upon the case made before him in favor of the directors. This decision was reversed by the Court of Appeal.[1] Upon appeal to the House of Lords, the Court of Appeal's decision was reversed and the trial justice's decision restored. The decision of the House of Lords was that the directors were not liable, inasmuch as their statement in the prospectus as to the use of steam power was made by them in the honest belief that it was true. The main opinion in the case was by Lord HERSCHELL, whose discussion, treatment of and conclusions from all the leading English cases upon actions of deceit were accepted by the others in their opinions. These conclusions were thus summarized and stated by Lord HERSCHELL: "*First.* In order to sustain an action of deceit there must be proof of fraud and nothing short of that will suffice. *Secondly.* Fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth, or recklessly careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false has obviously no such honest belief. *Thirdly.* If fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made. * * * In my opinion, making a false statement through want of care falls far short of, and is a very different thing from, fraud, and the same may be said of a false representation honestly believed, though on insufficient grounds. * * * I am unable to hold that anything less than fraud will render directors or any other persons liable in an action of deceit."[1]

[1] See Peek *v.* Derry, 37 Ch. Div. 541.

§ 202. The rule adhered to in England.— In a later English case it appeared that one who was the principal partner in a trading firm concurred in steps for turning the partnership into a company with limited liability. His name appeared on the prospectus as managing director of the new company, with a note that he would not join the board till after the transfer of the

[1] Derry *v.* Peek, (1889), 14 App. Cas. 337. Lord HERSCHELL took occasion to say further: "At the same time I desire to say distinctly that when a false statement has been made the questions whether there were reasonable grounds for believing it, and what were the means of knowledge in the possession of the person making it, are most weighty matters for consideration. The ground upon which an alleged belief was founded is a most important test of its reality. I can conceive many cases where the fact that an alleged belief was destitute of all reasonable foundation would suffice of itself to convince the court that it was not really entertained, and that the representation was a fraudulent one. So, too, although means of knowledge are, as was pointed out by Lord BLACKBURN in Brownlie v. Campbell, (5 App. Cas. at page 952), a very different thing from knowledge, if I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just as fraudulent as if he had knowingly stated that which was false. I have arrived with some reluctance at the conclusion to which I have felt myself compelled, for I think those who put before the public a prospectus to induce them to embark their money in a commercial enterprise ought to be vigilant to see that it contains such representations only as are in strict accordance with fact, and I should be very unwilling to give any countenance to the contrary idea. I think there is much to be said for the view that this moral duty ought to some extent to be converted into a legal obligation, and that the want of reasonable care to see that statements made under such circumstances are true should be made an actionable wrong. But this is not a matter for fit discussion on the present occasion. If it is to be done the legislature must intervene and expressly give a right of action in respect of such a departure from duty. It ought not, I think, to be done by straining the law, and holding that to be fraudulent which the tribunal feels cannot properly be so described. I think mischief is likely to result from blurring the distinction between carelessness and fraud and equally holding a man fraudulent whether his acts can or cannot be justly so designated."

business of the company had been completed. He did not issue the prospectus, but furnished materials for it; saw it in draft, though not in its final shape, and made alterations in it. It was held by the Court of Appeal that, under the circumstances, he was liable to the same extent as if he had been the person issuing the prospectus. The prospectus contained a statement that the business had paid seventeen per cent upon the capital employed in it. This statement, it appeared, might be true if "capital employed" did not include the business premises, or only included their value subject to mortgages upon them, but was grossly untrue if the whole value of the business premises was taken as part of the capital. This action was brought by one who had taken shares on the faith of the prospectus for damages for misrepresentations. The Court of Appeal held that, in order to make a person liable for damages for misrepresentation, it was not enough that the statement should be untrue, and made without any reasonable ground for believing it to be true, but it must be made dishonestly; that the onus of proving dishonesty lay on the plaintiff; that if the party making the statement believed, however unreasonably, that it was true, he was not liable. And as the plaintiff in this case had not shown that the statement was made dishonestly, the Court of Appeal reversed the judgment and dismissed the action.[1]

§ 203. Officers conspiring to wreck a corporation.— The power given to a president of a corporation to borrow money will not embrace the power to buy stock in the corporation, or

[1] Glasier *v.* Rolls, (1889) 42 Ch. Div. 436, following Derry *v.* Peek, 14 App. Cas. 337. As to the liability of corporation and officers making them for damages resulting to individuals from false statements of such officers in prospectuses or otherwise, see Moffat *v.* Winslow, 7 Paige, 124; National Exchange Co. *v.* Drew, 32 Eng. Law & Eq. Rep. 1, 14; Pontife *v.* Bignold, 3 Man. & Gr. 63; Bagshaw *v.* Seymour, 93 Eng. Com. Law Rep. 873; Johnson *v.* Goslett, 3 C. B. (N. S.) 569; Colt *v.* Woolaston, 2 P. Wms. 154; Green *v.* Barrett, 1 Sim. 45; Jones *v.* Garcia Del Rio, 1 Tur. & Russ. 297; Blain *v.* Agar, 1 Sim. 37; Gerhard *v.* Baley, 20 Eng. Law & Eq. Rep. 130; Colman *v.* Riches, 29 Eng. Law & Eq. Rep. 323; Hichens *v.* Congreve, 4 Russ. 562; Walburn *v.* Ingilby, 1 Mylne & K. 61; Foss *v.* Harbottle, 2 Hare, 461; Pasley *v.* Freeman, 3 Term Rep. 51; Shrewsbury *v.* Blount, 2 Scott's N. R. 588; Gallager *v.* Brunel, 6 Cowen, 346; Allen *v.* Addington, 7 Wend. 9; Bailey *v.* Mayor, etc., 3 Hill, 531; City of Buffalo *v.* Holloway, 3 Seld. 493; Culver *v.* Avery, 7 Wend. 384; Upton *v.* Vail, 6 Johns. 181; Barney *v.* Dewey, 13 Johns. 224; Williams *v.* Wood, 14 Wend. 126.

other corporate stocks or such articles as the corporation may need in its business. Upon this construction of such a power given to a president of a corporation in an Illinois case where it appeared that the president of a private corporation, who held a controlling share of the stock, was given the power to borrow money, sold, as the agent of his wife, her stock to the company, and gave her judgment notes payable on demand, for such stock, upon which notes judgment was confessed in favor of the wife, under which judgment all the corporate property was sold, and the proof showed that the president, in the transaction, was seeking to break down the corporation, and transfer its property fraudulently to his wife, and there being proof of a conspiracy on the part of the president and secretary to wreck the corporation, the Supreme Court held that the sales of the corporate property under the judgments conferred were properly set aside on the bill of stockholders and creditors filed for that purpose.[1]

§ 204. President conspiring against corporation — terms on which the corporation could rescind the contract made by him.— A corporation sought to recover from defendant the money which had, as alleged, been paid out of its funds by its president, in carrying out a conspiracy between defendant, a holder of its stock, for such stock at par value when it was only worth seventy-five per cent of its par value, and the corporation itself was offering unsubscribed shares of its capital stock at eighty per cent of its par value, on the ground of fraud, etc., the corporation itself at the time being financially embarrassed and its then president acting under threats from the defendant of exposure of his having embezzled funds of the corporation. The Supreme Court of California held that the court below properly sustained a demurrer to the complaint of the corporation upon the ground that it did not state facts sufficient to constitute a cause of action.[2]

[1] J. W. Butler Paper Co. *v.* Jeffery, (1894) 151 Ill. 588.

[2] Bank of San Luis Obispo *v.* Wickersham, (1893) 99 Cal. 655; s. c., 34 Pac. Rep. 444. The court said, *arguendo:* "The [corporation] is not entitled to any relief because of the alleged fraud practiced upon it in the sale of the stock without a complete rescission of the contract of sale; and to effect this it was incumbent upon [the corporation] to act with reasonable diligence and return or offer to return to defendants the stock received from them under the contract. It cannot be permitted to retain the shares of stock thus received by it, and at the same time recover from defendants the

§ 205. Promoters of corporations accountable for profits. — The cases settle that it is incumbent upon a promoter of a corporation, if he wish to sell property of his own to it, to make full and fair disclosure of his interest and position with respect to the property, and to furnish the corporation with a board of directors capable of forming a competent and impartial judgment as to the wisdom of the purchase, and the price to be paid; and, if he do not, he will not be allowed to retain any profit he may

money paid to them as the purchase price of such stock. This would be contrary to justice, and can receive no countenance in a court of equity. There is no averment in the complaint of any offer on the part of [the corporation] to return the stock purchased and [it] apparently rested satisfied with the contract for more than fifteen years. Counsel for [the corporation] do not dispute the general proposition that, to entitle one to rescind a contract, he must restore to the other party every thing of value received from him under such contract; but it is claimed by them that the stock was extinguished by the sale, and, therefore, cannot be legally returned, and that all defendant Wickersham can justly claim is to receive in the statement of the accounts demanded in the complaint a credit for the value of such stock at the time of the sale. We do not agree with counsel on this point. The shares of stock were not extinguished by the sale in such sense that they could not be reissued by [the corporation] to any one subsequently subscribing for shares of its capital stock. [The corporation's] purchase did not reduce the number of shares which [it] was authorized to issue by its articles of incorporation. The only effect of the transaction was to reduce the amount of the subscribed capital stock leaving the [corporation] free to again issue the same number of shares to any one desiring to subscribe for its capital stock. Cook Stock & S. §§ 282, 314; 1 Moraw. Priv. Corp. § 114; State *v.* Smith, 48 Vt. 266; Williams *v.* Manufg. Co., 3 Md. Ch. 451; Railway Frog Co. *v.* Haven, 101 Mass. 398. The contract of sale was *ultra vires*, and resulted in an illegal withdrawal of [the corporation's] capital actually paid in, but the stock was not actually extinguished, and so long as there remained that number of shares of its capital stock unsold the [corporation] could at any time have issued a new certificate therefor, and tendered the same to the defendants which would in legal effect have been a tender of the same shares sold by them to [the corporation]." In Coal Co. *v.* Lotspeich, (Ky.) 20 S. W. Rep. 378, the president of the coal company entered into a contract with one of the stockholders to deliver to him a quantity of coal, the pay therefor to be applied on the payment of the individual indebtedness of the president to the stockholder. The stockholder brought an action to enforce the contract and asked to be permitted to apply the price of the coal on the debt. The Kentucky Court of Appeals, in passing upon the question, said: "The pleadings do not present the question of fraud by way of defense, but, nevertheless, in construing a contract made between officers of a corporation, by which a corporate liability is attempted to be created to the one officer or the other, that construction should be placed on terms most favorable to the corporation; and particularly when the great weight of the evidence, and in fact all of it, shows that corporate property was being held, by reason of this contract, to pay an individual debt of one director to the other."

[1] Plaquemines Tropical Fruit Co. *v.* Buck, (N. J. Eq. 1893) 27 Atl. Rep. 1094, in which the chancellor reviews the cases and discusses the subject at large.

[2] Yale Gas Stove Co. *v.* Wilcox, (1894) 64 Conn. 101; s. c., 29 Atl. Rep. 303. The court reviewed a number of cases to which the defendant's counsel had cited it, and then discussed the relations of promoters to the corporations which they helped to form, as follows: "A 'promoter' has been defined to be a person who organizes a corporation. It is said to be not a legal, but a business term, 'usefully summed up in a single word, a number of business operations familiar to the commercial world by which a company is generally brought into existence.'" Bowen, J., in Printing Co. *v.* Green, 28 Wkly. Rep. (Q. B. Div. 1880) 351, 352. That such persons occupy a fiduciary relation toward the company or corporation whose organization they seek to promote is well settled by the decisions of both [America and England]. Lord Cotton prefers to call them "trustees." Bagnall *v.* Carlton, 6 Ch. Div. 385. Sir George Jessel, M. R., in a case (Phosphate Co. *v.* Erlanger, 5 Ch. Div. 73) said: "Promoters stand in a fiduciary relation to that company which is their creature." In Erlanger *v.* Phosphate Co., L. R., 3 App. Cas. 1218, the lord chancellor said of promoters: "They stand, in my opinion, undoubtedly in a fiduciary position. They have in their hands the creation and molding of the company. They have the power of defining how, and when, and in what shape, and under what supervision, it shall start into existence, and begin to act as a trading corporation. If they are doing all this in order that the company may, as soon as it starts into life, become, through its managing directors, the purchasers of the property of themselves (the promoters) it is, in my opinion, incumbent upon the promoters to take care that, in forming the company, they provide it with an

have made out of the corporation in such a sale.[1] It appeared in a case reserved from the Superior Court for the adjudication by the Supreme Court of Errors for Connecticut, that the promoter of a corporation had secretly agreed with a patentee to form this corporation to buy his patent, the patentee to pay the promoter half of the price paid for the patents. The promoter induced subscriptions to the stock of the corporation by stating that he was subscribing on equal terms with the rest, and being elected a director, voted for the resolution to buy the patents. The Supreme Court held that the corporation might recover of him (the promoter) his secret profits, and that it was not obliged to rescind the purchase, and so destroy its own reason for being. The secret contract between the promoter and the owner of the patents was held by the court to be void as against public policy.[2]

§ 206. Promoters obtaining stock of corporation for nothing.— In a case in the federal court it appeared that two individuals, as promoters of a projected corporation, entered into an agreement with the owners of certain patents and this proposed corporation, by which a certain number of shares were to be issued to these owners for the patents. They then offered the public an option to take stock in the corporation, disclosing the purchase of the patents, and that a portion of the stock was to be issued to the former owners in part payment, but not that they were to have stock on different terms or conditions. They were elected president and treasurer of the corporation as was further agreed between them and the owners of the patents. They succeeded in placing a large amount of the stock at seven dollars per share, obtaining their own stock for nothing. In this action against them it was held that they occupied a fiduciary relation to the other shareholders, and were liable to account in one of several modes for the benefit of the shareholders.[1] As to the measure of damages, the court said: "I think the company had a right to elect, (1) whether they would have the shares transferred back to them; or (2) if the shares had been sold, that these defendants should turn over the entire profit made by the sale; or (3) that the company may say, 'Although you have derived no profit by selling the shares, yet you deprived us of placing them with other persons, and you must, therefore, pay us the sum we have lost by reason of our being deprived of the right of placing these shares with other persons.'"[2]

executive; that is to say, with a board of directors, who shall both be aware that the property which they are asked to buy is the property of the promoters, and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote and form a joint-stock company and then sell his property to it; but I do say that if he does, he is bound to take care that he sell it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to the promoter, but to some other person." Continuing, "Lord O'Hagan, referring to the same subject, expressed a similar opinion in even more emphatic language, declaring that, while an original purchase might be legitimate, and not less so because the object of the purchaser was to sell it again, and to sell it by forming a company which might afford them a profit on the transaction, yet 'the privilege given them for promoting such a company for such an object involved objections of a very serious kind. It required, in its exercise, the utmost good faith, the completest truthfulness and a careful regard to the protection of the future stockholders.'" The test, therefore, of the validity of such transactions is that it must, in all its parts, be open and fair, so that the promoters shall not, in fact, substantially act both as vendors and vendees, and in the latter capacity approve a transaction suggested by them in the former. Foss *v.* Harbottle, 2 Hare, 461, 468; McElhenny's Appeal, 61 Pa. St. 188; Simons *v.* Vulcan Oil & Mining Co., 61 Pa. St. 202; Densmore Oil Co. *v.* Densmore, 64 Pa. St. 43; Pittsburg Mining Co. *v.* Spooner, 74 Wis. 307; s. c., 42 N. W. Rep. 259; South Joplin Land Co. *v.* Case, 104 Mo. 572; s. c., 16 S. W. Rep. 390; In re British Seamless Paper Box Co., 17 Ch. Div. 467; Sewage Co. *v.* Hartmont, 5 Ch. Div. 394. In the last case the distinctive feature was that the vendors paid the commission to the trustees, who received the property on behalf of the company. They were compelled to pay it to the company. In Hichens *v.* Congreve, 1 Russ. & M. 150 (on appeal, 4 Russ. 562), three promoters induced their company to buy a mine for £25,000, of which they received from the vendor, and divided among themselves, £15,000. This they were compelled to account for to the company. Similar cases are Beck *v.* Kantorowicz, 3 Kay & J. 230; Printing Co. *v.* Green, 28 Wkly. Rep. (Q. B. Div. 1880) 351; Mining Co. *v.* Grant, 11 Ch. Div. 918; Bagnall *v.* Carlton, 6 Ch. Div. 385; Kent *v.* Brickmaking Co., 17 Law T. (N. S.) 77; Water Co. *v.* Flash, 97 Cal. 610; s.c., 32 Pac. Rep. 600. See, also, Mallory *v.* Mallory-Wheeler Co., 61 Conn. 135; s. c., 23 Atl. Rep. 708, and the recent English case: In re North Australian Territory Co., Archer's Case, (1892) 1 Ch. 322. See, also, Ore Co. *v.* Bird, 33 Ch. Div. 85; Gover's Case, 1 Ch. Div. 182; Atwool *v.* Merryweather, 37 L. J. Ch. 35; Sewage Co. *v.* Hartmont, 5 Ch. Div. 395; Pittsburg Mining Co. *v.* Spooner, 74 Wis. 307; s. c., 42 N. W. Rep. 259; 24 Am. & Eng. Corp. Cas. 1; In re Cape Breton Co., 26 Ch. Div. 221; s. c., on appeal, 29 Ch. Div. 795; Ladywell Mining Co. *v.* Brookes, 34 Ch. Div. 398; s. c., on appeal, 35 Ch. Div. 400.

[1] Chandler, Receiver, *v.* Bacon, (1887) 30 Fed. Rep. 538; Browne *v.* National Color Printing Co., ibid. Colt, J., said: "The defendants could not lawfully [take their shares of stock without consideration, while other stockholders paid seven dollars per share]. As promoters of the new company, they occupied a fiduciary relation towards it similar to that of agent to a principal, and they had no right in these negotiations to derive any advantage over other stockholders without a full and fair disclosure of the transactions, and any secret profits so made they must refund to the company. That this may have been done without any fraudulent intent, or that the price paid for the patents was fair and reasonable, cannot retrieve these defendants. The law forbids them, from their position, to secretly derive any benefit over other stockholders, and makes them accountable to the company for any profit so derived." Citing Bagnall *v.* Carlton, 6 Ch. Div. 371; Whaley, etc., Co. *v.* Green, 5 Q. B. Div. 109; Sombrero Phosphate Co. *v.* Erlanger, 5 Ch. Div. 73; Emma Silver Mining Co. *v.* Grant, 11 Ch. Div. 918; Densmore Oil Co. *v.* Densmore, 64 Pa. St. 43; McElhenny's Appeal, 61 Pa. St. 188; Simons *v.* Vulcan Oil, etc., Co., 61 Pa. St. 202; Emery *v.* Parrott, 107 Mass. 95; Getty v. Devlin, 54 N. Y. 403.

[2] Chandler, Receiver, *v.* Bacon, (1887) 30 Fed. Rep. 638; Browne *v.* National Color Printing Co., ibid.; citing Carling's Case, 1 Ch. Div. 115, 126, 127;

§ 207. Jurisdiction of equity courts as to breaches of trust, etc.— The United States Supreme Court long since accepted as settled law, both in England and the United States, that courts of equity in both countries have a jurisdiction over corporations, at the instance of one or more of the stockholders, to apply preventive remedies by injunction, to restrain those who administer them from doing acts which would amount to a violation of charters, or to prevent any misapplication of their capitals in profits, which might result in lessening the dividends of stockholders or the value of their shares, as either may be protected by the franchises of a corporation, if the acts intended to be done create whatever the law denominated a breach of trust. And the jurisdiction extends to inquire into and to enjoin, as the case may require that to be done, any proceedings by individuals, in whatever character they may profess to act, if franchise, or the denial of a right growing out of it, is involved, for which there is not an adequate remedy at law.[1] In a case where the directors recognized their duty to resist the collection of a state tax upon the corporation (a bank), their refusal to do so was held to be an act contrary to the obligation which the charter imposed upon them to protect what they conscientiously believed to be the franchise of the bank, and was a breach of trust; that it amounted to an illegal application of the profits due to the stockholders of the bank, into which a court of equity will inquire to prevent its being made.[2] Officers and directors of a corporation, being trustees of the stockholders, in securing to themselves an advantage not common to all the stockholders, as, for instance, executing a mortgage to themselves, to secure indebtedness of the corporation to themselves, would be guilty of an unauthorized act, plainly a

McKay's Case, 2 Ch. Div. 1; De Ruvigne's Case, 5 Ch. Div. 306; Nant-y-glo, etc., Co. *v.* Grave, 12 Ch. Div. 738. Contracts with promoters, see Bash *v.* Culver Gold Mining Co., 7 Wash. 122; s. c., 34 Pac. Rep. 462; Weatherford, M. W. & N. W. R. Co. *v.* Granger, (Tex. Civ. App.) 23 S. W. Rep. 425; Winters *v.* Hub Mining Co., 57 Fed. Rep. 287; Burbank *v.* Dennis, (Cal. 1894) 35 Pac. Rep. 444; Cornell *v.* Corbin, 64 Cal. 197; s. c., 30 Pac. Rep. 629; Ex-Mission Land & Water Co. *v.* Flash, 97 Cal. 610; s. c., 32 Pac. Rep. 600.

[1] Dodge *v.* Woolsey, (1855) 18 How. 331; citing Cunliffe *v.* Manchester & Bolton Canal Co., 2 Russ. & Mylne Ch. 480, *n.*; Ware *v.* Grand Junction Water Co., 2 Russ. & Mylne, 470· Bagshaw *v.* Eastern Union Railway Co., 7 Hare Ch. 114; Ang. & Ames on Corp. (4th ed.) 424.

[2] Dodge *v.* Woolsey, (1855) 18 How. 331.

breach of trust, for which a stockholder would be entitled to a remedy in a court of chancery.[1] Contracts made by the directors of a railroad corporation for the construction of the road, for running cars of another corporation upon its road, for mining its coal lands and purchasing the coal so mined, which allow exorbitant prices for work done and material furnished, that are advantageous to the other contracting parties and injurious to the railroad corporation, in which the directors, or a controlling majority of them, are interested adversely to the corporation, in short, contracts made with themselves, are frauds such as courts of equity will relieve against in a proper case.[2] For such acts the remedy would be as follows: Parties who make such contracts and receive the pecuniary benefit of them can at law be made responsible in damages, or held in equity to compensation for the loss suffered. In a proper suit such contracts may be adjudged void, and then an accounting ordered, on the basis of a fair compensation for what may have been done in the way of construction, building, opening mines, furnishing coal, etc., and what had been received for such work and materials. But this can be done only in an action brought by *bona fide* stockholders who may have taken no part in and had no interest in the fraudulent contracts, in case the corporation be disabled to complain.[3] The directors of a joint-stock corporation, who willfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable as trustees to make good that loss; and they are also liable if they suffer the corporate funds to be lost or wasted by gross negligence and inattention to the duties of their trust.[4] And a court of equity has jurisdiction to entertain a suit to enforce the proper remedy in such a case. If the corporation, or the then present directors of the corporations and the parties who have made themselves answerable for the loss, refuse to bring such a suit, then an action will lie in the name of a stockholder in his own behalf or in behalf of all.[5] The chancellor

[1] Koehler *v.* Black River Falls Iron Co., (1862) 2 Black, 715; citing Ang. & Ames on Corp. (ed. 1861) § 312; The Charitable Corporation *v.* Sutton, 2 Atk. 404; Robinson *v.* Smith, 3 Paige, 220; Hodges *v.* New England Screw Co., 1 R. I. 312; York & North Midland Ry. Co. *v.* Hudson, 19 Eng. L. & E. 361.

[2] United States *v.* Union Pacific Railroad Co., (1878) 98 U. S. 569, 609, 610.

[3] Ibid.

[4] Robinson *v.* Smith, (1832) 3 Paige, 222, a case involving the loss of corporate funds by a speculation in stocks of other corporations by the directors.

[5] Ibid.

held in this case that independent of the Revised Statutes of New York the Court of Chancery had jurisdiction, so far as the rights of the individual corporators were concerned, to call the directors to account, and to order them to make suits of action for losses arising from a fraudulent breach of trust.[1] And in such suits the corporation is a necessary party.[2] Directors, like any other trustees, may be restrained from the performance of unauthorized acts, or to rescind and cancel them when performed. And the stockholders, occupying the relation of *cestuis que trust*, may invoke the aid of equity to thus protect their interests.[3] Officers of a corporation may be compelled by a court of equity to account for any breach of trust, but the jurisdiction for this purpose is over the officers personally.[4] Where directors of a corporation have so mismanaged its affairs as to be fraudulent, a bill may be maintained against them personally by a stockholder. The stockholder may, in such case, interpose for the protection of the corporation.[5] In a stockholder's action brought by himself on behalf of a corporation against its officers for misapplication and misappropriation of its funds and charging a violation of trust on their part, the right of action in the corporation must be alleged, just as if the action had been brought by the corporation. And he cannot join in the action causes of action accruing to

[1] Ibid. See, also, Scott *v.* Depeyster, 1 Edw. Ch. 513; Cumberland Coal Co. *v.* Sherman, 30 Barb. 553; Cross *v.* Sackett, 16 How. Pr. 63.

[2] Robinson *v.* Smith, (1832) 3 Paige, 222; Cunningham *v.* Pell, (1836) 5 Paige, 607.

[3] Chetlain *v.* Republic Life Ins. Co., (1877) 86 Ill. 220.

[4] Neall *v.* Hill, 16 Cal. 145.

[5] Watts' Appeal, (1875) 78 Pa. St. 370. In Bank of St. Marys *v.* St. John, Powers & Co., (1854) 25 Ala. 566, 609, an action to enforce the liability of directors of a bank for unfaithful management of its affairs, the Supreme Court of Alabama, as to there being no equity in the bill, speaking through Ligon, J., said: "It may be remarked that strict trusts are admitted to be open at all times to the examination of a court of equity, and an unfaithful trustee has been constantly brought before it, and made both to discover the fund belonging to the trust and to account for its management and misapplication. If fraud in the management of the fund is charged in the bill, by one interested in the trust estate, and who has been injured in consequence of such fraud, there is no doubt of the jurisdiction of the court. If, superadded to the matters of trust and fraud, the bill, as in this case, seeks a discovery and account, it will embrace nearly every ground on which the original jurisdiction of the Chancery Court is said to rest. In such case it is immaterial whether a court of law can afford to the complainant partial or full relief, in the matter complained of; it cannot hinder the aggrieved party from resorting to a court of equity for redress."

himself personally with causes of action belonging to the corporation.[1]

§ 208. When a court of equity is not open to the complaints of stockholders.— A company was organized upon property, and not cash, as its capital, bonds and stock being issued to the organizers and owners of the land, their respective holdings being in proportion to their rights in the property. The stockholders, and the holders of the bonds as well, filed a bill in equity complaining of the management of the company's affairs by its officers. The court held that stockholders, after voting for and approving of an appropriation of corporate funds to a purpose fairly within the scope of the corporate powers, will not, in the absence of fraud, be heard to complain thereof in a court of equity. Neither can they proceed in chancery to protect their equitable rights, unless the corporation has been dissolved, or has itself been prevented from proceeding by the misconduct of its officers.[2] Goff, Circuit Judge, in his opinion, states the complaints of these stockholders and declares as to the rights of stockholders as follows: "As stockholders the complainants are interested in the proper management of the company; in the payment of all its liabilities; in the sale of its real estate, and the distribution of its assets. They charge that the funds of the company have been wasted, and its assets misappropriated and diverted to purposes wholly foreign to those for which it was organized, to their loss and injury. I do not find that these charges are sustained. The appropriations, donations and subscriptions to stock by the company to the various purposes and enterprises set forth in the bill were all made with the assent of the stockholders, including complainants, most of whom voted for them, as they were in the line of the enterprise in which the company was engaged, and to which the stockholders were committed. It was simply an effort to carry out the object had in view when the company was organized, for which the one-fourth portion of the income received from the sale of lots was set apart, as was provided in the charter and nominated in the bond. I find that the stocks and bonds held and owned by defendant,

[1] Whitney *v.* Fairbanks, (1893) 54 Fed. Rep. 985; citing Briggs *v.* Spaulding, 141 U. S. 132; s. c., 11 Sup. Ct. Rep. 924.

[2] McGeorge *v.* Big Stone Gap Imp. Co., (1893) 57 Fed. Rep. 262.

issued by other corporations, were purchased and secured with the one-fourth part so received, and not with trust funds to which the bondholders were entitled. The directors of the defendant seem to have advised fully with its stockholders, and consulted with its bondholders, more so than is usually done; and, as the evidence discloses, they were always governed by the advice received. It is true that a number of the enterprises that were assisted with the funds of the company have not as yet developed into remunerative investments by demonstrating their dividend-earning capacities. Still the evidence shows that the officers honestly endeavored in these instances to enhance the interest of the company, and that, in their efforts, they had the approval of the stockholders and the commendation of the present complainants. It is clearly shown that complainants were not only aware of the proceedings had at the meetings of the stockholders and directors, when the expenditures complained of were authorized, but that they gave them their cordial support." Upon this statement of the facts the court held that the bill of the complainants was not maintainable.[1]

[1] Ibid. *Arguendo*, it was said: "Stockholders of a corporation that has been managed without fraud will not be permitted after they, for reasons of their own, have become dissatisfied with the plan of organization, or the management thereof, to force the abandonment of the business, and compel the majority of the stockholders to submit to the will of the minority by the decree of a court of equity. If they had this power it would frequently be exercised to the detriment of the corporation, the very existence of which might be thus destroyed, or the value of its stock seriously impaired. Rival companies might make it to the interest of this minority so to act, or the stock of a corporation might be purchased with such object in view, and the result would be that the security relied upon by those investing in corporate property would be seriously impaired. The charters under which corporations are organized, and the laws by virtue of which they are created, provide the way in which they shall be managed, as well as the mode of voting the stock and the manner of electing the officers thereof; and, if these provisions have been fairly complied with, then there is no ground for the interference of a court of equity at the complaint of a dissatisfied minority shareholder. If he disapproves of the management that has been conducted without fraud, and under the requirements of the law, his only remedy is to elect new officers in favor of another policy by appealing to the stockholders, or, failing in that, to sell his stock and retire. Certainly, the equity courts of the country will not undertake to manage it for him, nor will they, under such circumstances, take jurisdiction for the purpose of closing up the affairs of the corporation. Such power is never exercised in the absence of a statute giving the jurisdiction, and I find no such enactment applicable to this case. In the absence of such legislation the business matters of a corporation can only be controlled, or its charter privileges taken from it, by the proper and usual proceedings in such cases provided in the courts of law. Chancellor KENT," said the court, "in a leading case on this subject, said: 'I admit that the persons who from time to time exercise the corporate powers may, in their character of trustees, be accountable to this court for a fraudulent breach of trust, and to this plain and ordinary head of equity the jurisdiction of this court over corporations ought to be confined.' Attorney-General *v.* Utica Ins. Co., 2 Johns. Ch. 371. 'It cannot be concealed,' said the chancellor in Bayless *v.* Orne, 1 Freem. Ch. (Miss.) 173, 'that to decree the prayer of complainant's bill would be to decree a dissolution of the corporation. In this respect it differs materially from bills which have frequently been entertained by courts of equity at the instance of stockholders against the directors of a corporate company to compel them to account for the improper use of funds, or to restrain them from violating their trust. That a court of equity, as such, has not jurisdiction or power over corporate bodies for the purpose of restraining their operations, or winding up their concerns, is, I think, well settled by various authorities.'" See on this subject Verplanck *v.* Insurance Co., 1 Edw. Ch. 84; Attorney-General *v.* Bank of Niagara, 1 Hopk. Ch. 354; Neall *v.* Hill, 16 Cal. 145. In Treadwell *v.* Salisbury Manufg. Co., 7 Gray, 393, it is said: "Indeed, it is too well settled to admit of question that a court of chancery has no peculiar jurisdiction over corporations to restrain them in the exercise of their powers, or control their action, or prevent them from violating their charter in cases where there is no fraud or breach of trust alleged as the foundation of the claim for equitable relief. Their rights and duties are regulated and governed by the common law, which, in most cases, furnishes ample remedies for any excess or abuse of corporate powers and privileges, which may injuriously affect either public or private rights. It is only when there is no plain and adequate remedy at law, and a case is presented which entitles a party to equitable relief, under some general head of chancery jurisdiction, that a bill in equity can be maintained against a corporation. And this rule is applicable to stockholders as well as to other persons." See Ang. & A. Corp. § 312; Grant on Corp. 71, 271; Mozley *v.* Alston, 1 Phil. Ch. 790; Hodges *v.* Screw Co., 1 R. I. 350; Baker *v.* Railroad Co., 34 La. Ann. 754. The circuit judge resumed: "The rule is also well established that a corporation claiming redress for wrongs must proceed through its regularly appointed agents. It is only when the company has been dissolved, or is prevented from proceeding by the misconduct of its officers, that the stockholders may themselves proceed in chancery for the protection of their equitable rights. If the directors refuse to act, or are themselves guilty of a wrong that the majority of the stockholders refuse to correct, equity will interfere at the

§ 209. Remedy in equity.— A stockholder may bring a suit in equity where a president of a corporation which has been steadily earning profits has received the same and not accounted for them, and the directors are under his influence and control and mere instruments to do his bidding, and have surrendered the entire control of the affairs of the corporation to him, for such relief

as he may be entitled to.[1] And in addition to these facts, should it appear that a number of the directors, especially if including a relative of the president, are not *bona fide* stockholders, but made such merely by a voluntary transfer of stock to them by him to qualify them as directors, it may not be alleged that the directors have been requested to bring suit and refused.[2] One having a claim for a loss against a mutual insurance corporation is entitled to bring his bill in equity against the directors of such a corporation who, having funds belonging to it in their hands to pay the claim, have neglected and refused to pay it, and fraudulently applied the funds to other purposes.[3] The managers of a saving fund are liable in equity as trustees for the proper management of the fund.[4] The proper remedy for the defrauded depositors of a saving fund is a bill in equity against the directors of such an institution; and these directors, although ignorant of the fact of a fraud in its organization, will be liable to the depositors for the proper care and management of the deposits intrusted to its safe-keeping.[5] The directors of a saving fund will be held liable to the depositors for maladministration of their office, and suits may be brought by the depositors.[6] But directors who did

suit of a stockholder. Morawe. Priv. Corp. §§ 239, 381, 386; Moore *v.* Schoppert, 22 W. Va. 282, 291; Hawes *v.* Oakland, 104 U. S. 450, 460; Foss *v.* Harbottle, 2 Hare, 493. In this case the complainants allege that they control a majority of the shares of stock of the defendant. If that is so they will have no trouble in calling a stockholders' meeting of the company and therein so voting their stock as to correct the wrongs of which they now complain, and fully protect their interests in the future."

[1] Rogers *v.* La Fayette Agricultural Works, (1875) 52 Ind. 296.

[2] Ibid.; citing March *v.* Eastern R. R. Co., 40 N. H. 548; Robinson *v.* Smith, 3 Paige, 222; Dodge *v.* Woolsey, 18 How. 331; Brewer *v.* Boston Theatre, 104 Mass. 378; Hodges *v.* New England Screw Co., 1 R. I. 312; Goodin *v.* Cincinnati, etc., Co., 18 Ohio St. 169; Peabody *v.* Flint, 6 Allen, 52; Sears *v.* Hotchkiss, 25 Conn. 171; Wright *v.* Oroville Gold, Silver & Copper Mining Co., 40 Cal. 20; Allen *v.* Curtis, 26 Conn. 456.

[3] Lyman *v.* Bonney, (1869) 101 Mass. 562.

[4] Leffman *v.* Flanigan, (1863) 5 Phil. 155.

[5] Ibid.

[6] Maisch *v.* Saving Fund, (1862), 5 Phil. 30. SHARSWOOD, P. J., in his opinion, said: "We are by no means announcing any new doctrine when we say that the directors of corporations are responsible for gross negligence, as well as fraud, in the management of the interest intrusted to them. It has received the indorsement of courts of the highest character for learning. Robinson *v.* Smith, 3 Paige, 222; Scott *v.* Depeyster, 1 Edw. Ch. 513; Allen *v.* Curtis, 26 Conn. 456. No one doubts the personal liability of the president, treasurer and other officers who are paid for their services. Why should there exist any doubt as to directors who are also officers? The difference is only in the measure and degree of their respective responsibility. It would be monstrous if a director could look on and see a cashier or treasurer embezzling the funds of a corporation and not be responsible if he gave no information, and took no measures to prevent it. Equally monstrous would it be to say that the directors of a saving fund, insurance office or bank should allow their names to go forth to the public in connection with representations of the nature and value of the assets which, if the ordinary means of examination and supervision had been resorted to, they would have easily discovered to be false. If they have such unbounded faith in the faithfulness and integrity of their officers as to trust the whole affairs of the corporation to their management, without any attention on their part, they must accept the alternative of responsibility for their conduct. It is important that the community at large should know this, and that gentlemen of wealth and respectability should be careful how they suffer their names to be held forth as the trustees or managers of institutions to which they have not the time or inclination to give their personal attention."

not participate, and never took their seats in the board, and against whom there be no allegation of knowledge of the fraud, need not be held liable.[1] A president of a corporation may be called upon by bill in equity to account for and make restitution of any part of the property of the corporation confided to his care where he has improperly applied it to his own use.[2] Where by a contract with its president a corporation may deliver to him, its unissued stock, with power of sale, as security for money loaned the corporation by him, the contract will be enforced if shown to have been made for the benefit of the corporation, and to be just and fair.[3] An action by a stockholder to set

[1] Maisch *v.* Saving Fund, (1862), 5 Phil. 30. In Flagler Engraving Machine Co. *v.* Flagler, (1884) 19 Fed. Rep. 468, it appeared that the organizers of the joint-stock company put in as a part of the capital stock certain patent rights and by fraudulent puffing induced others to purchase the stock at fictitious prices. It was held that whether the purchasers could set aside the sales or not, they were not entitled to gain control of the company and pursue their remedy against the fraudulent directors in the name of the company.

[2] Combination Trust Co. *v.* Weed, 2 Fed. Rep. 24.

[3] Ibid. In Pneumatic Gas Co. *v.* Berry, (1885) 113 U. S. 322; s. c., 5 Sup. Ct. Rep. 525, where the objection was made to a contract entered into with a director of the corporation seven years after its execution and had been repeatedly ratified, the Supreme Court of the United States said: "A court of equity does not listen with much satisfaction to the complaints of a company that transactions were illegal which had its approval, which were essential to its protection, and other benefits of which it has fully received. Complaints that its own directors exceeded their authority come with ill grace when the acts complained of alone preserved its existence." In Jesup *v.* Illinois Central R. Co., (1890)

aside a resolution of a board of trustees of a corporation fixing the salaries and compensation to be received by them respectively as secretary, treasurer and vice-president of the corporation, and to compel the restoration of the money paid them, although it is not binding upon the corporation and may at the election of the corporation be set aside, cannot be maintained unless he shows that the corporation ought to exercise its rights to avoid the resolution or contract made by its trustees in which they were personally interested.[1] The presumption does not arise in such an action that the trustees acted dishonestly, which must be overcome on their part by affirmative evidence, as it would in case the corporation had sought to set aside the contract.[2] A stockholder has a right of action for losses sustained by him by

43 Fed. Rep. 483, it was held that seasonable resistance could not be predicated of a case of a merely voidable contract, where the party complaining had not simply been silent for twenty years, but with knowledge of the facts, or with free opportunity to ascertain them, has enjoyed the fruits of the contracts, and treated it as valid. Mr. Justice HARLAN said generally: "The rule is a wholesome one that requires the court, in cases of merely voidable contracts, to withhold relief from those who, with knowledge of the facts, or with full opportunity to ascertain the facts, unreasonably postpone application for relief. A contract not wholly invalid when executed, nor prohibited by law, as relating to some illegal transaction, and which is, therefore, voidable only, may become, by the acts of the parties or by long acquiescence, binding upon them, especially where the nature of the property which is the subject of the contract is such that its value may be affected by its relations to other property of like kind, and by the changing business of the country." As to the right of one wishing to fix liability upon directors of a corporation on account of fraudulent transactions by which he had been endangered to file a bill for discovery against them personally, see Stebbins *v.* Cowles, (1835) 10 Conn. 399.

[1] MacNaughton *v.* Osgood, (1886) 41 Hun, 109.

[2] Ibid. As to the rule which would govern in case the corporation itself sought to set aside such a resolution, it was said by the court: "The corporation may avoid such a contract with its trustees, but cannot do so except upon equitable terms, and must restore to him what is received from him. Duncomb *v.* N. Y., H. & N. R. R. Co., 84 N. Y. 190. Hence the corporation, upon rescinding, ought to pay the reasonable value of the services of these officers, rendered in a department of labor beneficial to it, and outside of the duty of direction which the office of director implies. See Metropolitan Elevated Railway Co. *v.* Manhattan Railway Co., 14 Abb. N. C. at pages 258, 259, where the case of Jackson *v.* New York Central Railroad Co., 2 Sup. Ct. (T. & C.) 653; affirmed, 58 N. Y. 623, is commented upon, and other cases are cited in which the right of a director to recover for such services is shown to rest solely upon *quantum meruit*, and such, we have no doubt, is the law." That it must be a clear case demanding its interference before a court will

reason of the fraudulent acts and a misapplication or waste of the corporate funds and property by an officer of the corporation.[1] But before bringing, in his own name, an action against an officer of a corporation to recover damages for a fraudulent misappropriation and conversion by such officer of the corporate earnings and funds, he must first apply to the corporation to bring the action and the latter refuse to bring it. In case the corporation do refuse to bring the action, then the stockholder may bring it in behalf of himself and other stockholders. making the corporation a party defendant, alleging its refusal in his complaint and proving it.[2] And an action in his own name, without making the corporation a party defendant, to recover the difference between the actual loss and depreciation will not be authorized by the fact that the wrongful acts of the officer have depreciated the market value of the capital stock held by the stockholder to an extent greater than its share of the actual loss sustained.[3] Where the officers and trustees of a corporation alien and transfer the whole property of a corporation to one to enable him to appropriate it to his own use and to render valueless the stock of the corporation to effect a dissolution of the corporation without due process of law, and also to oust one who has been chosen to have the "management of the affairs of" the corporation for a stated time and for the purpose of defrauding its creditors, an action will lie to set aside such alienation as fraudulent.[4] And such manager would be a proper party to bring such an action under the New York Code of Civil Procedure, sections 1781, 1782, which provide that such an action may be brought by a creditor of the corporation, or by a trustee, director, manager, or

interfere with the management of a corporation, see Barnes *v.* Brown, 80 N. Y. 527; Chautauqua County Bank *v* Risley, 19 N. Y. 381; Hawes *v.* Oakland, 104 U. S. 460.

[1] Greaves *v.* Gouge, (1877) 69 N. Y. 154. As to a stockholder's having a remedy for losses produced by the fraud, culpable neglect of duty or a violation of law, on the part of an officer of the corporation, see Bissell *v.* Michigan Southern & N. I. R. R. Co., 22 N. Y. 275; Butts *v.* Wood, 37 N. Y. 317; Cross *v.* Sackett, 6 Abb. Pr. 247, 265; House *v.* Cooper, 16 How. Pr. 293; Mead *v.* Mali, 15 How. Pr. 347; Crook *v.* Jewett, 12 How. Pr. 19; Cazeaux *v.* Mali, 25 Barb. 578; Abbot *v.* Am. H. R. Co., 33 Barb. 578; Howe *v.* Deuel, 43 Barb. 505; Gardiner *v.* Pollard, 10 Bosw. 675; Gray *v.* New York & Virginia St. Ship Co., 5 T. & C. 224.

[2] Greaves *v.* Gouge, (1877) 69 N. Y. 154.

[3] Ibid.

[4] Beecher *v.* Schieffelin, (Spl. Term Sup. Ct. 1883) 4 N. Y. Civ. Pro. Rep. 230.

other officer of the corporation having a general superintendency of its affairs.[1] A treasurer of a corporation failing to pay over to it money which he has collected whereby the corporation is compelled to borrow money and to pay a rate of interest greater than six per cent in an action against him for the recovery of that money, would not be liable in equity to pay on the sums he had withheld more than six per cent interest should the bill not seek to recover any profits he had made.[2] Where stock of a corporation has been fraudulently issued by one of its officers and transferred to a third person as collateral security for a debt, it is in the power of a court of equity, upon a bill filed for the purpose by a stockholder, to order the certificates of such stock returned and canceled.[3] And in such a bill the corporation is not a necessary party.[4] A treasurer of a corporation who has sold for its benefit a bond issued by it, in case he is unable or refuses to disclose the exact amount for which he sold it, will be chargeable in equity for at least the full market value of the bond at the time of the sale.[5] In this case the treasurer of the corporation had purchased on his own account a quantity of coal, when it was not his duty as treasurer to purchase it, and with no intention of selling it to the corporation. He afterwards sold it to the corporation at its then fair market value, which was more than it cost him. It was held that he was not chargeable in equity for the difference in price between what he paid for it and sold it for to the corporation.[6] The Supreme Court of New York, in a case where two of the directors of a corporation acquired title to patents for use in the business in their own name, and transferred them to another corporation, which in turn assigned them to one of these directors as trustee, held that a decree that this director should assign all the interest which he held individually and as trustee in the patents to the receiver appointed in the action, and that both of these directors should account for all the profits they had made in the transactions was proper.[7] An action at law can-

[1] Ibid. As to the rules governing the bringing of suits to compel the ministerial officers of a private corporation to account for a breach of official duty or misapplication of corporate funds, see Hyde Park Gas Co. v. Kerber (1879) 5 Bradw. (Ill.) 132.

[2] Parker v. Nickerson, (1884) 137 Mass. 487.

[3] Campbell v. Morgan, (1879) 4 Bradw. (Ill.) 100.

[4] Ibid.

[5] Parker v. Nickerson, (1884) 137 Mass. 487.

[6] Ibid.

[7] Averill v. Barber, (1889) 53 Hun, 636; s. c., 6 N. Y. Supp. 255.

not be maintained by a stockholder of a corporation against the officers and directors of the corporation to recover damages for willful waste of the assets, by reason of which the value of his shares of stock may have been decreased, and he may have become liable to an assessment upon his shares. His remedy lies in a court of equity.[1] It should appear very clearly that the loss of a stockholder in a diminution of the value of his stock was occasioned by the gross negligence or willful misconduct of directors to charge the officers of a corporation with such loss which he may allege had been caused by their mismanagement.[2] While accountable in equity as trustees, in case the officers of a

[1] Hirsh v. Jones, (1893) 56 Fed. Rep. 137. McCormick, Circuit Judge, said: "The authorities are uniform in support of the proposition that where the cause of action affects all the interests of the corporation, as such, the corporation is the proper party to sue, and on its refusal to sue, or falling under the control of those liable to the suit, and thus not to be trusted to bring and conduct the action, the injured stockholder has his remedy in equity, and must seek it in that jurisdiction." Citing Kendig v. Dean, 97 U. S. 423; Dewing v. Perdicaries, 96 U. S. 193; Dodge v. Woolsey, 18 How. 341; Conway v. Halsey, 44 N. J. Law, 462.

[2] Neall v. Hill, 16 Cal. 145. As to the rule with reference to an action by a stockholder of a corporation against the directors for a misapplication of funds of the corporation, see Cogswell v. Bull, (1870) 39 Cal. 320; Parrott v. Byers, 40 Cal. 614. In Allen v. Curtis, (1857) 26 Conn. 456, an action on the case brought by a stockholder of a bank against the directors of the same for mismanagement and willful neglect on their part of the affairs of the bank which caused insolvency of the bank and a loss to him in the value of his stock, the case being referred to the Supreme Court of Connecticut on a demurrer, the court sustained the demurrer, and in their opinion said: "The general rule of law is, that an action at law must be brought by the person having the title or right to the damages which are sought to be recovered for the injury. Hence the *Woodbury Bank* should have brought this suit. It is *its* property which has been misappropriated and lost, and the damages to be recovered belong to it — to be sure — in trust for billholders, depositors and other creditors, if any there be, and finally for the stockholders, but for all of them and not for some of them exclusively. The *bank* then must sue. It may compromise and settle or release the defendants on terms mutually satisfactory, which the stockholders cannot do, and, should they do it, it would be no bar to a suit afterwards brought by the bank. In this respect the defendants are liable to the bank as any other agents or persons would be for robbing or defrauding it or in any way injuring the corporate property. * * * Besides the directors of the bank are the agents of the bank. The bank is the only principal, and there is no such trust for or relation to a stockholder as has been claimed by the plaintiff. The entire duty of the directors growing out of their agency is owed to the bank, which, under the charter, is the sole representative of the stockholders and the legal protector and defender of their property. Nor is any other

corporation have gone out of office, the remedy against them for an appropriation of corporate funds to their own use is at law and not in equity unless discovery is sought.[1]

§ 210. **Malfeasance of the president of a corporation — a stockholder's remedy.**— In a federal court a stockholder's bill in equity charged that the president of the corporation had taken possession and control of the moneys of the corporation, depositing them in bank in his own name, in defiance of the express provision of the by-laws, and drawing them out on his own check, in his own discretion, for his own purposes; that especially he had in his own hands the sum of $25,660, money of the corporation, which he had converted to his own use, and for which he failed and refused to account; that by this action, and the further misuse of the corporation's funds by lending them in his own name, this stockholder had failed to receive his proper share of the funds of the company in the shape of a dividend on his stock; that all his efforts to ascertain the truth about this misuse of funds by the president, on examination of the books, or in calling the president to an account therefor, had been baffled and defeated by the direct and active effort of the president himself, aided by the other officers, going so far as to receive and put a motion for investigation made at a stockholders' meeting, and that there was a definite purpose so to use the affairs of the company as to depress the stock so as to compel this stockholder to sell out at a loss. There was a general demurrer to the bill. The United States Circuit Court overruled the demurrer and sustained the bill.[2]

protector or defender necessary until the bank shall neglect its duty in refusing to call the directors to account; in which event, upon a case properly stated and with proper parties before the court, a court of equity may grant relief according to the existing exigency." Citing Smith *v.* Hurd, 12 Met. 371; Bishop *v.* Houghton, 1 E. D. Smith, 566; Ang. & Ames on Corp. § 312; Hodsdon *v.* Copeland, 16 Me. 314; Hersey *v.* Veazie, 24 Me. 9. See, also, Ruby *v.* Abyssinian Society, 15 Me. 306.

[1] Bay City Bridge Co. *v.* Van Etten, 36 Mich. 210.

[2] Ranger *v.* Champion Cotton-Press Co., (1892) 52 Fed. Rep. 611. SIMONTON, J., said, referring to the demurrer and its admissions: "Here we have the admission that a complaining stockholder in a trading corporation has been defrauded and deprived of his share of its property applicable to dividends, by the action of the president in misusing for his own purposes the moneys of the company. That every effort made by him to ascertain

§ 211. **When a demand upon directors to bring suit is not required.**— Certain stockholders of an Indiana corporation brought an action against the corporation and the officers of the same charging a conspiracy between the latter, they controlling a majority of the stock, by which in electing and continuing cer-

the facts connected with this charge have been thwarted by the positive and distinct refusal, at the hands of the president, made at an annual meeting of the stockholders, to give any information or explanation whatever. This admission is made. It is denied that a court of equity can give any relief. Strong, indeed, must be the formal or technical difficulties which will forbid this court from, at least, hearing such a complaint." The bill and the rights of the stockholder are then discussed in these words: "Does the bill make out *prima facie* a case for equitable relief? There can be no doubt that in a proper showing this court will come to the aid of a minority of stockholders. Dodge *v.* Woolsey, 18 How. 331. The doctrine is well stated in Waterman on Corporations (page 578, § 319): 'A court of equity will enjoin, on behalf of the stockholders, any improper alienation or disposition of the property, other than for corporate purposes, and will restrain the commission of acts which are contrary to law, and tend to the destruction of the franchises, as well the improper management of the business of the corporation, or a wrongful diversion of its funds, and in such case equity may grant relief at the suit of a single stockholder.'" The court resumed: "There are three classes of cases in which stockholders may complain. A minority may object to the business policy pursued by the majority, as tending to injure, perhaps destroy, their interests. In such cases the court will seldom or never interfere. The majority must govern, unless there be a palpable abuse of power, or an interference with vested rights. Another class of cases is where the rights and interests of a corporation as a whole are threatened by the action of a third party, an outsider, and the corporate authorities, through inadvertence, negligence or willfulness, will not move in their defense." In such cases, following Dodge *v.* Woolsey, *supra*, the courts of the United States lent a ready ear to the complaint of stockholders who interfered in behalf of the corporate rights. But this indulgence of the courts was greatly abused. Many cases were brought in the United States courts in which the jurisdiction was secured by collusion between a non-resident stockholder and the corporation which itself could not come into this court. This abuse was rebuked in Hawes *v.* Oakland, 104 U. S. 450. The evil was cured by the passage of the ninety-fourth equity rule, consequent on this case. This rule, by its terms, is made applicable to "every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation." Hawes *v.* Oakland (page 454) shows that these words, "other parties," means "an outsider." But this case, and the rule consequent upon it, do not apply to cases in which there is a real contest between the stockholder and his corporation. Leo *v.* Railway Co., 17 Fed. Rep. 273. Hawes *v.* Oakland draws the distinction broadly and clearly: "That the vast and increasing proportion of the active business of modern life is done by corporations, should call into exercise the beneficent

tain ones of them as officers they were enabled to, and did, misappropriate and waste the funds of the corporation, by a system of paying exorbitant and unreasonable salaries to each other as officers and thus disabled the corporation to declare dividends, there being many different allegations of wrongdoing on their part in the complaint. The Supreme Court sustained the overruling of the demurrers to each of the allegations in the

powers and flexible methods of courts of equity is neither to be wondered at nor regretted, and this is specially true of controversies growing out of the relations between the stockholder and the corporation of which he is a member. The exercise of this power in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is undisputed. * * * The case before us goes beyond this." After stating that case and the principle of Dodge *v.* Woolsey, in both of which the action of an outsider was the *gravamen* of the complaint, the court adds (page 454): "This is a very different affair from a controversy between the shareholder of a corporation and the corporation itself, or its managing directors or trustees, or the other shareholders who may be violating his rights, or destroying the property in which he has an interest." SIMONTON, J., then refers to the case before him: "The bill in this case does not complain of any business policy on the part of the corporation or of the other stockholders, nor does it charge supineness, or neglect or collusion with any attack on corporate rights, interests or privileges, by an outsider. The complainant charges that the president has converted to his own use moneys of the company in which, as a stockholder, complainant has an interest, because they were applicable to dividends; that the president misuses his powers, and conducts the business of the corporation to his own purposes; that he controls and uses, in his own private banking account, and for his own private purposes, all the funds of the company, against the express provisions of the by-laws, and that in this he is sustained by the officers of the company, who aided him in a peremptory refusal even to consider a motion of inquiry on this subject, made at a general meeting of stockholders. He charges that his own personal rights are infringed and for this he seeks his remedy. As his rights are similar to those of the other stockholders, he makes them parties to his suit, as parties in interest, so that they may take sides as they are advised, and, at least, may be present at the division of the common property, and see that he gets his just share and no more. His prayer is that the money unlawfully converted be returned, and out of it a dividend be declared, and that he get his dividend. This is a suit within the corporation, concerning no one but the stockholders and the company, seeking rights, claimed as a stockholder, against the company and other stockholders. The complainant could not work out his case through the corporation." The court then stated the particular facts as to who hold the stock and are officers, and said: "Under these circumstances, it would be absurd to require the complainant to ask these gentlemen to institute, in

complaint, holding that each one of them stated a cause of action against the defendants. One of the main contentions of the defendants was that there should have been a demand upon them to bring the action and an allegation in the complaint that it had been made. The court held this was particularly a case in which such a demand upon the directors was not required.[1]

the name of the corporation, a suit against [the president] involving the grave charges of this suit. Tazewell Co. *v.* Farmers' L. & T. Co., 12 Fed. Rep. 752; Heath *v.* Railway Co., 8 Blatchf. 347."

[1] Wayne Pike Company *v.* Hammons, (1891) 129 Ind. 368. *Arguendo*, it was said: "Conceding that the cases are numerous in which such demand is necessary, we do not think this case belongs to that class. In this case something more than a mere accounting is sought, namely, the appointment of a receiver to take charge of the corporate property. The parties out of whose hands it is proposed to take the management of the affairs of the corporation, and who are called upon to account for a misappropriation and conversion of the corporation assets, constitute a majority of the directors. It would not be reasonable to require those who are charged with a conversion of the assets to bring suit in the name of the corporation against themselves, and to furnish the proof to sustain the charge, and at the same time ask the court to take the property from their charge on account of their misconduct. Such a suit would be a farce, and it would be beyond reason to refuse the appellees relief because they did not demand that such a proceeding be had before they commenced their suit. Cook on Stocks & Stockholders, section 741, in treating this subject, says: 'There are occasions when the allegation that the stockholder has requested the directors to bring suit, and they have refused, may be omitted since the request itself is not required. This occurs when the corporate management is under the control of the guilty parties. No request need then be made or alleged, since the guilty parties would not comply with the request; and even if they did the court would not allow them to conduct the suit against themselves.' The author cites many authorities which fully support the text. Mr. Waterman, in his work on Corporations, vol. 1, page 467, says: 'The corporation may call its officers to account if they willfully abuse their trust or misapply the funds of the company; and if it refuses to sue, or is still under the control of those who must be made defendants in the suit, the stockholders who are the real parties in interest may file a bill in their own names, making the corporation a party defendant, or part of them may file a bill in behalf of themselves and all others standing in the same relation. Where a majority of the stock of a corporation is held by one family, who vote away the corporation profits for salaries, a court of equity will remedy the fraud. Cook Stock & Stockholders, section 567. In the case of Carter *v.* Ford, etc., Co., 85 Ind. 180, it was held that where the corporation was in the hands of its enemies the stockholders might maintain an action, which, if successful, would inure to the benefit of the corporation.' See, also, Rogers *v.* La Fayette, etc., Works, 52 Ind. 296. 'The officers of a corporation are its agents, and they are governed by the rules of law applicable to other agents, as between themselves and their principal, in so

§ 212. When a stockholder may bring an action.— It appearing in a case that a stockholder had written to the president of a corporation to take action against certain directors for breaches of their trust, and he replied that he had resigned the presidency two years before this time, and further that the directors complained of were the active managers of the business, and there being no evidence that any successor to the president had been elected in the meantime, the Supreme Court of New York held that the stockholder could properly bring an action in his own name against these directors.[1] An action for an accounting and an injunction in the name of a corporation may be authorized and maintained by the president of a corporation who is also a trustee, without the authority of the board of trustees, or against

far as such rules relate to honesty and fair dealing in the management of the affairs of their principal. They can no more use the business of their principal for their own private gain than any other agent, and should they do so they should be held to the same strict rule of accountability as the agent of a private person. Port v. Russell, 36 Ind. 60; Aberdeen Railway Co. *v.* Blakie, 1 Macq. 461; Michoud *v.* Girod, 4 How. 502; Cumberland, etc., Co. *v.* Sherman, 30 Barb. 553. If the appellants conspired together for the purposes alleged in the complaint, each became liable for any act done by any of the three in furtherance of the common design. By the act of conspiring together the conspirators assumed to themselves the attribute of individuality so far as regards the proscution of the common design, thus rendering what was said or done by any one in furtherance of the design, the act of all. [Citing authorities.]'"

[1] Averill *v.* Barber, (1889) 53 Hun, 636; s. c., 6 N. Y. Supp. 255. As to the general rule in such cases, see Doud *v.* Wisconsin P. & S. Railway Co., 65 Wis. 108; s. c., 25 N. W. Rep. 533; Boyd *v.* Sims, 3 Pickle (Tenn.), 771; s. c., 11 S. W. Rep. 948; Bacon *v.* Irvine, 70 Cal. 221; 11 Pac. Rep. 646; Dannmeyer *v.* Coleman, 11 Fed. Rep. 97; City of Detroit *v.* Dean, 106 U. S. 537; s. c., 1 Sup. Ct. Rep. 560; Rathbone *v.* Parkersburg Gas Co., 31 W. Va. 798; s. c., 8 S. E. Rep. 570; Alexander *v.* Searcy, 81 Ga. 536; s. c., 8 S. E. Rep. 630; City of Chicago *v.* Cameron, 120 Ill. 447; s. c., 11 N. E. Rep. 899; Dunphy *v.* Traveller Newspaper Association, 146 Mass. 495; s. c., 16 N. E. Rep. 426; Allen *v.* Wilson, 28 Fed. Rep. 677; Slattery *v.* St. Louis & N. O. Transportation Co., 91 Mo. 217; s. c., 4 S. W. Rep. 79; Taylor *v.* Holmes, 127 U. S. 489; s. c., 8 Sup. Ct. Rep. 1192; Dimpfel *v.* Ohio & M. Railway Co., 110 U. S. 209; s. c., 3 Sup. Ct. Rep. 573; McHenry *v.* Railroad Co., 22 Fed. Rep. 130; Foote *v.* Mining Co., 17 Fed. Rep. 46; Bill *v.* Telegraph Co., 16 Fed. Rep. 14; City of Quincy *v.* Steel, 120 U. S. 241; s. c., 7 Sup. Ct. Rep. 520; Byers *v.* Rollins, 13 Colo. 22; s. c., 21 Pac. Rep. 894; Poole *v.* Association, 30 Fed. Rep. 513; Wilcox *v.* Bickel, 11 Neb. 154; s. c., 8 N. W. Rep. 436; Davis *v.* Gemmell, 70 Md. 356; s. c., 17 Atl. Rep. 259; Hazeltine *v.* Belfast & M. L. Railroad Co., 79 Me. 411; s. c., 10 Atl. Rep. 328; Oliphant *v.* Woodburn C. & Mining Co., 63 Iowa, 332; s. c., 19 N. W. Rep. 212.

its express direction where a majority of the trustees may have wrongfully converted corporate funds and threaten to convert other of the funds, especially where the neglect of the board of trustees to sue, and its resolution to discontinue a suit already commenced, are simply acts in furtherance of the unlawful design of the majority of the trustees.[1] Where the assignee in

[1] Recamier Manufg. Co. *v.* Seymour, (Com. Pl. New York City, 1889) 5 N. Y. Supp. 648. In Merchants & Planters' Line *v.* Waganer, (1882) 71 Ala. 581, a stockholder's action against the corporation and certain directors based upon alleged mismanagement, etc., STONE, J., asks: "Have the complainants averred sufficient facts to authorize them, representing, as they do, a minority of the stock, to come into equity for the redress of the wrongs they complain of while the corporate powers are still in exercise?" and answers as follows: "Very true, the present bill charges that three, a majority of the directors, have combined and formed a ring for their own private profit, at the expense of the other stockholders and many acts of wrongdoing are charged against those three directors. No act is charged that is *ultra vires*, and there is no averment that the corporation effects are imperiled by the insolvency of the parties. Neither is there averment in the bill that any request has been made known, soliciting the use of the corporate name in bringing suit against the alleged offenders. Nor is it shown that any attempt has been made to obtain a meeting of the stockholders. In Tuscaloosa Manufacturing Co. *v.* Cox, 68 Ala. 71, the questions presented arose on bill filed by a minority of stockholders. True, the abuses charged in that case were less flagrant than those complained of in this; but the difference is in degree, not in kind. In that case we ruled that complainants had shown no ground for equitable relief. We said: 'In the government of corporations much must be left to the judgment and discretion of the directory, and much must be credited to the fallibility of human judgment. If it be supposed an unwise course is being pursued, or that the interests of the corporation are suffering, or likely to suffer though the inefficiency or faithlessness of an official an appeal should first be made to the directory or governing body, to redress the grievance. Failing there, in ordinary cases, the next redress will be found in the power of the ballot, which usually comes into exercise at short intervals.' We quoted approvingly the case of Greaves *v.* Gouge, 69 N. Y. 154, and Brewer *v.* Boston Theatre, 104 Mass. 378. In Hawes *v.* Oakland, 104 U. S. 450, Justice MILLER, in delivering the opinion of the court, stated that a stockholder could appeal to the courts for relief, 'when the board of directors or a majority of them, are acting for their own interest, in a manner destructive of the corporation itself, or of the rights of the other shareholders.' That is precisely what is averred in this case. 'But,' Justice MILLER adds, 'in addition to the existence of grievances which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach, to obtain, within the corporation itself, the redress of his grievances, or action in conformity to

insolvency of a corporation refuses to sue, a stockholder may sue to enforce a claim of the corporation against its managing officer for diversion of funds. At the same time it has been held that a stockholder, seeking to enforce rights of the corporation against its managing officer for diversion of funds arising from an unauthorized "swapping" of checks, who, alleging that, being a director, he protested in writing against such acts when first apprised of them, but that they were nevertheless continued for two years, showed facts convicting himself of laches, by failing to aver that he was ignorant of such continuance.[1] A stockholder of a construction company which had constructed a railroad which became connected with and was controlled by another corporation, a railroad company, the latter assuming by contract the liabilities of the company absorbed by it to the construction company, brought his action as a stockholder of the latter against the construction company and the railroad company which had

his wishes. He must make an earnest, not a simulated, effort with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains; and he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it.' The principles commend themselves to our approval by the strongest of considerations. A corporation, to attain the highest success, should, like a family, dwell together in unity. And when disputes arise between members of this body politic, or law-created household, they should, if possible, be adjusted among themselves. It should be a strong case to justify a resort to personal litigation, which almost invariably leads to personal alienation if not open hostility. Pratt *v.* Jewett, 9 Gray, 34." As to actions against ministerial officers of a corporation for breaches of trust and misappropriation of funds, see Hyde Park Gas Co. *v.* Kerber, 5 Bradw. (Ill.) 132. As to what is required and what not required of stockholders before they can institute suits for mismanagement, etc., on the part of directors and officers, for the redress of grievances, see Bell *v.* Montgomery Light Co., (Ala.) 15 So. Rep. 569; McCrory *v.* Chambers, 48 Ill. App. 445; George *v.* Central R. R. & Bkg. Co. of Georgia, (Ala.) 14 So. Rep. 752; Earle *v.* Seattle, L. S. & E. Ry. Co., 56 Fed. Rep. 909; Sage *v.* Culver, 71 Hun, 42; s. c., 24 N. Y. Supp. 514; Putnam *v.* Ruch, 54 Fed. Rep. 216; Putnam *v.* Ruch, 56 Fed. Rep. 416; Atchison, T. & S. F. R. Co. *v.* Comrs., 51 Kans. 617; Eaton *v.* Robinson, (R. I.) 27 Atl. Rep. 595; Pondir *v.* New York, L. E. & W. R. Co., 72 Hun, 384; s. c., 25 N. Y. Supp. 560; 31 Abb. N. C. 29; Whitney *v.* Fairbanks, 54 Fed. Rep. 985; Fitzgerald *v.* Fitzgerald & Mallory Construction Co. et al., (1894) 41 Neb. 374; s. c., 59 N. W. Rep. 839.

[1] Streight *v.* Junk, (1893) 59 Fed. Rep. 321.

also, by purchase of the stock of the construction company, and electing so great a number of its directors, obtained full control of its management, charging great wrongs perpetrated on the part of the railroad company acting through its directors and management so as to create liabilities to the construction company growing out of their wrongdoing for which this action was brought to secure such equitable decree against the railroad company in favor of the construction company, its co-defendant, as would inure to the benefit of the complainant and others holding judgments and claims against the construction company. The Nebraska Supreme Court held that the action was maintainable.[1] Two receivers of this construction company had been appointed, it appeared in the petition in this case, one in a court of general jurisdiction in two different states. It was insisted upon the part of defendants that as this appeared the receivers were indispensable parties to the suit. But the court held to the contrary.[2] There was also a contention in this case, it being found by the court that this stockholder and one other representing one-fifth interest in the whole of the shares of the corporation, having acquiesced in these particular acts of the directors of the railroad corporation, the corporation itself was estopped from recovery. The court below found in accordance with this contention. The Supreme Court of Nebraska, however, held this finding of the court below to be erroneous. The position of the latter as to the law involved upon this point is thus stated in the syllabus by the court: The acquiescence of a stockholder will not preclude a recovery in an action brought by him in a proper case for the benefit of such corporation in respect of wrongs committed by the managing officers of said corporation against it for the benefit of another corporation in which they were also officers. In such case, while the stockholder is nominally the plaintiff, he is only nominally so; the action is in reality between the corporations joined as defendants — the one as the party wronged, the other as the party which profited by the wrong.[3] The corporation, a railroad company,

[1] Fitzgerald *v.* Fitzgerald & Mallory Construction Co. et al., (1894) 41 Neb. 374; s. c., 59 N. W. Rep. 839.

[2] Ibid.

[3] Ibid. *Arguendo*, it was said by the court: "It is difficult to conceive why the acquiescence of stockholders in the wrong found by the court, whereby its ability to pay its debts was greatly impaired, should preclude the right of the construction company to relief as against such wrong. The trial court found that, aside from the acquiescence of [the two stockholders],

one of the defendants in this case, was held liable civilly for the damages occasioned by the torts of its officers, its directors, to the construction company, its co-defendant, those torts being the result of the acts of those directors of the railroad company while acting in its interest in the management of the financial settlements based upon the contracts between the two on behalf of the construction company, which management the railroad company dominated.[1]

there had been the active commission of the wrong by the other four-fifths of the construction company's stock. Of what greater avail should be the mere acquiescence of the other fifth? In Quincy *v.* Steel, 120 U. S. 244; s. c., 7 Sup. Ct. Rep. 520, it was said that a suit brought by a stockholder for the benefit of the corporation was in fact a suit for the corporation itself. That the acquiescence of stockholders merely as such could be held to imply more than by an affirmative act such stockholder, as such, could perform, can scarcely be seriously argued. In the brief of the defendants is found the following quotation from the language of FIELD, J., in Humphreys *v.* McKissock, 140 U. S. 311, 312; s. c., 11 Sup. Ct. Rep. 779: 'The property of a corporation is not subject to the control of individual members, whether acting separately or jointly. They can neither incumber nor transfer that property, nor authorize others to do so. The corporation, the artificial being created, holds the property, and alone can mortgage or transfer it, and the corporation acts only through its officers, subject to the conditions prescribed by law.' In this brief it is also stated that Justice FIELD, in the case cited, approved the language of Chief Justice SHAW in Smith *v.* Hurd, 12 Met. (Mass.) 385, where he says: 'The individual members of a corporation, whether they should all join or each act severally, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent or servant to account, or discharge them from any liability. Should all the stockholders join in a power of attorney to any one, he could not take possession of any real or personal estate, any security or choice in action, could not collect a debt or discharge a claim or release damages arising from any default, simply because they are not the legal owners of the property, and damage done to such property is not any injury to them. Their rights and their powers are limited and well defined.' If all the stockholders, by joining in a power of attorney for that purpose, could not release damage arising from any default, upon what principle could such release be inferred from the mere acquiescence in such release by one-fifth in amount of the stockholders? Most manifestly such an anomaly cannot be tolerated, much less enforced, by judicial tribunals. In argument it is tenaciously contended, however, that the long acquiescence of the construction company effected the same result. There was no finding of such acquiescence by the court. Indeed, there could not be, consistently with the finding that the construction company was dominated in all things by the officers of the Missouri Pacific Railway Company [its co-defendant.]"

[1] Fitzgerald *v.* Fitzgerald & Mallory Construction Co. et al., (1894) 41 Neb. 374; s. c., 59 N. W. Rep. 839. It was

§ 213. Dissolution of a corporation by a scheme of a majority of stockholders and a sale of the property to themselves.— In a bill filed by a minority of stockholders of a corporation against the representatives of a majority of stockholders for an accounting as to the disposal of the property of the corporation to a new corporation formed by this majority of stockholders, the case disclosed therein was thus stated by WALLACE, J., of the United States Circuit Court: "A majority of the stockholders of a corporation resolve to avail themselves of their power as a quorum to sacrifice the interests of the minority

insisted that the acts of these directors were not imputable to the railroad company itself. This contention was disposed of by the Supreme Court of Nebraska in the following words: "The following apt language is employed by HARLAN, J., in the opinion of the Supreme Court of the United States in Railway Co. *v.* Harris, 122 U. S. on page 607; 7 Sup. Ct. Rep. 1286: 'In Railroad Co. *v.* Quigley, 21 How. 202, this court held that a railroad corporation was responsible for the publication by them of a libel in which the capacity and skill of a mechanic and builder of depots, bridges, station houses and other structures for railroad companies were falsely and maliciously disparaged and undervalued. The publication in that case consisted in the preservation in permanent form of a book for distribution among the persons belonging to the corporation, of a report made by a committee of the company's board of directors in relation to the administration and dealings of the plaintiff as a superintendent of the road. The court, under a full review of the authorities, held it to be the result of the cases that for acts done by the agents of a corporation, either *in contractu* or *in delicto*, in the course of its business and of their employment, the corporation is responsible as an individual is responsible under similar circumstances. In State *v.* Morris & Essex R. Co., 23 N. J. Law. 369, it was well said that, if the corporation has itself no hands with which to strike, it may employ the hands of others, and it is now perfectly well settled, contrary to the ancient authorities, that a corporation is liable *civiliter* for all torts committed by its servants or agents by authority of the corporation, express or implied. The result of the modern cases is that a corporation is liable *civiliter* for torts committed by its agents or servants precisely as a natural person, and that it is liable as a natural person for the acts of agents done by its authority, express or implied, though there be neither a written appointment under seal nor a vote of the corporation constituting the agency or authorizing the act. See, also, Salt Lake City *v.* Hollister, 118 U. S. 256, 260; s. c., 6 Sup. Ct. Rep. 1055; Steamboat Co. *v.* Brockett, 121 U. S. 637; s. c., 7 Sup. Ct. Rep. 1039; Bank *v.* Graham, 100 U. S. 699–702.' In Booth *v.* Bank, 50 N. Y. on page 400 *et seq.*, is found the following language: 'When an officer does an act which is within the general scope of his powers, although circumstances may exist which render the particular act a violation of his duty, the corporation is nevertheless bound by his acts as to persons dealing in ignorance of those circumstances, and is responsible to innocent third parties who have sustained dam-

stockholders for their own profit, by destroying the corporation and selling its property and franchises to themselves at half their real value. This scheme they have carried out, and now retain its fruits. They have thrust out the complainants, the minority, from their position as stockholders, terminating their relations with the corporation as such, and have deprived them from realizing what would belong to them upon a fair disposition and division of the corporate property." The court then discusses those acts and the powers of the majority and the rights of the minority of the stockholders, as follows: "It is to be observed that the

ages occasioned by such acts. And the liability of a corporation for the consequences of acts of its officers come within the scope of their general powers, and is not affected by the fact that the act which the officers have assumed to do is one which the corporation itself could not rightfully do. A corporation may do wrong through its agent as well as a private individual. Railroad Co. *v.* Schuyler, 34 N. Y. 30; Farmers & Mechanics' Bank *v.* Butchers & Drovers' Bank, 16 N. Y. 125; Bissell *v.* Railroad Co., 22 N. Y. 258; Bank of Genesee *v.* Patchin Bank, 13 N. Y. 309.' In Hussey *v.* King, (N. C.) 3 S. E. Rep. on page 926, DAVIS, J., delivering the opinion of the court, said: 'It was long thought that, as a corporation has no mouth with which to utter slander, or hand with which to write libels or commit batteries, or mind to suggest malicious prosecutions or other wrongs — as it was an artificial person and could speak and act only through the agency of others — it was not, therefore, liable for any torts except such as resulted from some act of commission or omission of its agents or servants while acting within the scope of granted powers, or wrongfully omitting and neglecting some duty imposed by its charter or by law; and, consequently, it was necessary to allege that the act committed was done while acting within the scope and power of the company, or that the act omitted was required to be performed. Whether it was wise to depart from this rule, that excepted corporations from liability for the acts of its agents in cases where the character of the act depended upon motives or intent, seems no longer an open question. The old idea, that because a corporation had no soul, it could not commit torts, or be the subject of punishment for tortious acts, may now be regarded as obsolete. The rights, the powers and the duties of corporate bodies have been so enlarged in modern times, and these artificial persons have become so numerous, and enter so largely into the every-day transactions of life, that it has become the policy of the law to subject them, so far as practicable, to the same civil liability for wrongful acts as attach to rational persons, and its liability is not restricted to acts committed within the scope of granted powers, but the corporation may be liable for an action for false imprisonment, malicious prosecution and libel. Pierce on Railroads, 273.' In Miller *v.* Railroad Co., 8 Neb. 219, it was said that a corporation is liable the same as a natural person for the tortious acts of its servants and agents in the course of their employment, but to make a corporation liable for such acts they must be connected with the transaction of the business for which the company was incorporated, for the officers themselves are the mere agents of the corporation, and their powers are necessarily limited within the scope of the purposes of the corporation. The stockholders, however, by electing officers, assume the risk of the faithful or unfaithful management of the corporation, and cases may arise where, if one of two innocent persons has to suffer, the one who has created the power and selected the persons to enforce it must sustain the loss."

[1] Citing Durfee *v.* Old Colony & F. R. Co., 87 Mass. (5 Allen) 250; Bill *v.* Western Union Tel. Co., 16 Fed. Rep. 19.

[2] Citing Clarke *v.* White, 12 Pet. 178.

[3] Menier *v.* Hooper's Telegraph Works, L. R., 9 Ch. App. Cas. 350, 354.

proceedings of the defendants were not outside of the charter or articles of association of the corporation, but, on the contrary, were carefully pursued according to the form of the organic law. They had a right to dissolve the corporation and dispose of its property and distribute the proceeds. The minority cannot be heard to complain of this, because the laws of Oregon permitted it and because it is an implied condition of the association of stockholders in a corporation that the majority shall have power to bind the whole body as to all transactions within the scope of the corporate powers.[1] Nor does it matter, in legal contemplation, that the majority were actuated by dishonorable or even corrupt motives, so long as their acts were legitimate. In equity, as at law, a fraudulent intent is not the subject of judicial cognizance unless accompanied by a wrongful act.[2] In other words, if the majority had the right to wind up the corporation at their election, and they availed themselves of it in the mode which was permitted by the organic law of the corporation, neither a court of law or equity can entertain an inquiry as to the motives which influenced them. The power to do this was undoubted." "But," the court said, "the right of the majority to sell the property to themselves at their own valuation is a very different matter; it cannot be implied from the contract of association, and will not be tolerated by a court of equity. As is said by MELLISH, L. J., in[3] [case cited below]: 'Although it may be quite true that the shareholders of a company may vote as they please and for the purpose of their own interests, yet the majority cannot sell the assets of the company and keep the consideration, but must allow the minority to have their share of any consideration which may come to them.' If the majority sell the assets to themselves they must account for their fair value. They cannot bind the minority by fixing their own price upon the assets. A majority have no right to exercise the control over the corporate management which legitimately

belongs to them for the purpose of appropriating the corporate property or its avails to themselves, or to any of the shareholders, to the exclusion or prejudice of the others.[1] In[2] [case cited below], the property of a company was transferred to two shareholders in lieu of their shares, and the company was thereby practically put an end to, and the debts were thrown on the remaining shareholders. This was sanctioned by a majority of the shareholders at a general meeting, but it was held that the majority could not bind the minority in such a transaction, and it was set aside."[3]

§ 214. The rights of the minority in such a case.— The same judge, in the same court, in the same case, upon its second hearing, thus states the position and insistment of the defendants: "They have adjusted their own interests on the basis of a consolidation of the two corporations and a continuance of their business as a joint venture; but they now insist that the interests of the minority stockholders, who have not been permitted to participate with them, shall be adjusted on the basis of a dissolution and a cessation of the business which they originally associated together to conduct. More than this, the defendants insist that the value of the assets, for the purpose of determining the interests of the minority, is fixed by the appraisal of persons selected by the defendants themselves, in whose selection the minority had no voice; and they have assumed to deny all recognition to those of the minority who will not consent to surrender their stock and accept a final dividend upon the basis of this appraisal." He then continues the discussion: "Plainly, the defendants have assumed to exercise a power belonging to the majority in order to secure personal profit for themselves without regard to the interests of the minority. They repudiate the suggestion of fraud, and plant themselves upon their rights as a majority to control the corporate interests according to their discretion. They err if they suppose that a court of equity will tolerate a discretion which does not consult the interests of the minority. It cannot be denied that minority stockholders are

[1] Citing Brewer *v.* Boston Theatre, 104 Mass. 378, 395; Preston *v.* Grand Collier Dock Co., 11 Sim. 327; Hodgkinson *v.* National Live Stock Ins. Co., 26 Beav. 473; Atwool *v.* Merryweather, L. R., 5 Eq. 464, note.

[2] Gregory *v.* Patchett, 33 Beav. 595.

[3] Ervin *v.* Oregon Ry. & Nav. Co., (1884) 20 Fed. Rep. 577, 580.

bound hand and foot to the majority in all matters of legitimate administration of the corporate affairs; and the courts are powerless to redress many forms of oppression practiced upon the minority under the guise of legal sanction which fall short of actual fraud. This is a consequence of the implied contract of association by which it is agreed in advance that a majority shall bind the whole body as to all transactions within the scope of the corporate powers. But it is also of the essence of the contract that the corporate powers shall only be exercised to accomplish the objects for which they were called into existence, and that the majority shall not control those powers to pervert or destroy the original purposes of the corporations.[1] It is for this reason that the majority cannot consolidate the corporation with another corporation and impose responsibilities and hazards upon the minority not contemplated by the original enterprise, unless express statutory authority for this purpose is conferred upon the majority. It is no more repugnant to the purposes of the association to permit the majority to merge and consolidate the corporation with another corporation than it is to permit them to dissolve it or abandon the enterprise for which it is created, where no reasons of expediency require this to be done. A dissolution under such circumstances is an abuse of the powers delegated to the majority. It is no less a wrong because accomplished by the agency of legal forms. In the language of Blackburn, J., in[2] [case cited below]: 'As the shareholders are, in substance, partners in a trading corporation, the management of which is intrusted to the body corporate, a trust is, by implication, created in favor of the shareholders that the corporation will manage the corporate affairs, and apply the corporate funds for the purpose of carrying out the original speculation.' When a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become, for all practical purposes, the corporation itself, and assume the trust relation occupied by the corporation towards its stockholders. Although stockholders are not partners, nor strictly tenants in common, they are the beneficial joint owners of the corporate property, having an interest and power of

[1] Citing Livingston *v.* Lynch, 4 Johns. Ch. 573; Hutton v. Scarborough Cliff Co., 2 Drew. & S. 514; Brewer *v.* Boston Theatre, 104 Mass. 378; Kean *v.* Johnson, 9 N. J. Eq. 401; Rollins *v.* Clay, 33 Me. 132; Clinch *v.* Financial Corporation, 4 Ch. App. 117; Brewer *v.* Clearwater *v.* Meredith, 1 Wall. 25.

[2] Taylor *v.* Chichester Ry. Co., L. R., 2 Exch. 379.

legal control in exact proportion to their respective amounts of stock. The corporation itself holds its property as a trust fund for the stockholders who have a joint interest in all its property and effects, and the relation between it and its several members is, for all practical purposes, that of trustee and *cestui que trust*.[1] When several persons have a common interest in property, equity will not allow one to appropriate it exclusively to himself or to impair its value to the others. Community of interest involves mutual obligation. Persons occupying this relation towards each other are under no obligation to make the property or fund productive of the most that can be obtained from it for all who are interested in it; and those who seek to make a profit out of it, at the expense of those whose rights in it are the same as their own, are unfaithful to the relation they have assumed, and are guilty at least of constructive fraud." [2]

§ 215. Principles applied to this particular case.— Applying the principles as to the acts of fiduciaries with reference to the property intrusted to them, established in such cases as [those cited below][3] to the case in hand, WALLACE, J., said: "* * * Although the minority of stockholders cannot complain merely because the majority have dissolved the corporation and sold its property, they may justly complain because the majority, while occupying a fiduciary relation towards the minority, have exercised their powers in a way to buy the property for themselves, and exclude the minority from a fair participation in the fruits of the sale. In the language of MELLISH, L. J., in Menier *v.* Hooper's Telegraph Works, 9 Ch. App. Cas. 350, 354: 'The majority cannot sell the assets of the company and keep the consideration, but must allow the minority to have their share of any consideration which may come to them.' The minority stockholders are, therefore, entitled to demand their fair share in the transaction, and to be placed upon terms of equality with the majority. It may be that

[1] Peabody *v.* Flint, 6 Allen, 52, 56; Hardy *v.* Metropolitan Land Co., L. R., 7 Ch. 427; Stevens *v.* Rutland R. Co., 29 Vt. 550.

[2] Ervin *v.* Oregon Ry. & Nav. Co., (1886) 27 Fed. Rep. 625; citing Jackson *v.* Ludeling, 21 Wall. 616, 622; Story Eq. § 323.

[3] Greenlaw *v.* King, 3 Beav. 49, 63; Gibson *v.* Jeyes, 6 Ves. 278; Torrey *v.* Bank of Orleans, 9 Paige, 663; Michoud *v.* Girod, 4 How. 555; Gardner *v.* Ogden, 22 N. Y. 327; and Hoyle *v.* Plattsburgh & M. R. Co., 54 N. Y. 315.

the property of the old company was not worth more than the sum fixed by the appraisers, estimating its value with a view of the winding up of the corporation; but for several months the property had been used by the defendants in a joint venture with the other property of the new corporation, and its value, at the time of the sale, should be estimated at what the property was worth as then situated. This results from the rule of equity which entitles those whose property has been misapplied by an agent or fiduciary to follow it into any form in which it has been converted, and impress it with a trust whenever its identity can be traced, or, at their election, to recover the value of the property in any form into which it has been transmuted. Story Eq. §§ 1261, 1262. If it was worth much more as a constituent of the new corporation than it would have been worth otherwise, the minority stockholders are entitled to the benefit of the increase. The majority of the stockholders are not to be permitted to segregate it from the conditions in which they have placed it, for the purpose of fixing its value to the minority. For this reason the estimate made by the appraisers is not controlling, even if it is of any value in determining the price for which the defendants should account. This is so, not only because the appraisers were the agents of those who were at the same time negotiating as the purchasers and the sellers of the property, but also because they adopted a basis of valuation which will not be sanctioned by a court of equity." [1]

§ 216. When a fraudulent assignment of a mortgage by the treasurer of a corporation will bind it.— In a case where it appeared that the treasurer of a savings bank, clothed with authority to do so, executed an assignment of a mortgage in the name of the bank in due form, and indorsed the note secured by it to a *bona fide* purchaser, it was held in the United States Circuit Court for the district of Massachusetts that the title passed, notwithstanding the treasurer perpetrated a fraud upon the bank, and converted to his own use the purchase money. It was further held that the corporation was estopped to prove, as against *bona fide* purchasers, either irregularity or fraud upon the part of its officers when acting within their authority.[2]

[1] Ervin *v.* Oregon Ry. & Nav. Co., (1886) 27 Fed. Rep. 625. A rehearing of this case was denied in 28 Fed. Rep. 833.

[2] Whiting *v.* Wellington, (1882) 10 Fed. Rep. 810. LOWELL, Circuit Judge, referring to a certificate of the treasurer given to the purchaser, that

§ 217. When a corporation may recover money fraudulently paid out by its treasurer.— Two manufacturing corporations of Massachusetts had a common treasurer. Money was loaned by one to the other when needed, and the loans were effected by the check of one payable to the order of the other drawn by the common treasurer. This treasurer had by a series of embezzlements from the corporations created a deficit in their funds. He had concealed this deficit by at certain times drawing checks in the name of one corporation, payable to the order of the other, and placing it with the funds of the latter. When his embezzlements were discovered these fraudulently drawn checks were about equally divided between the corporations. There was an action for accounting brought by one against the other claiming a large balance in the mutual account. The defendant corporation pleaded as a set-off the amount of its funds received by the plaintiff through these fraudulent checks, and the plaintiff contended that the transfers of checks from one company to the other were, in fact and law, payments by the treasurer to an innocent creditor without notice, and, therefore, could not be reclaimed; that the losses must be borne as they stood at the time of the discovery of the frauds. The Supreme Court of Judicature held that the corporation using the money was affected with the knowledge of its treasurer and the transaction did not amount to a payment of the deficit, and that the other corporation was not guilty of such negligence as to preclude it from recovering back the money.[1]

a certain note was found upon the records of the corporation, said: "The estoppel arises from the certificate. * * * In a recent case in England a statute declared that, unless certain things were done, no shares of a joint-stock company should be issued except for cash, and all which should be issued otherwise should be subject to assessment. Shares were issued as 'paid up,' and were bought by a *bona fide* purchaser. The company and its liquidator were held estopped to prove that the statute had not been followed. In re British, etc., Co., 7 Ch. D. 533; s. c. *nom.* Burkinshaw *v.* Nicolls, 3 App. Cas. 1004. In that case (page 1026) a very able judge says that the doctrine of estoppel *in pais* is a most equitable doctrine, and one without which the law of the country could not be satisfactorily administered. 'When a person makes to another the representation, 'I take upon myself to say such and such things do exist, and you may act upon the basis that they do exist,' and the other man does really act upon that basis, it seems to me it is the very essence of justice that, between those two parties, their rights should be regulated, not by the real state of the facts, but by that conventional state of facts which the two parties agree to make the basis of their action; and that is, I apprehend, what is meant by estoppel *in pais* or homologation.' This doctrine has been affirmed by the Supreme Court in a large class of cases where the facts are much more open to public observation than are the notes of a private corporation, in which counties and towns having power to issue bonds upon certain terms and conditions are held estopped to prove, as against *bona fide* purchasers, either irregularity or fraud on the part of their own officers in issuing the bonds, especially if they contain upon their face a certificate that the terms of the law have been complied with. These decisions do not depend upon the negotiable character of the bonds, excepting when there is a question of notice. Comrs. *v.* Aspinwall, 21 How. 539; Moran *v.* Comrs. of Miami, 2 Black, 722; Rogers *v.* Burlington, 3 Wall. 654; Grand Chute *v.* Winegar, 15 Wall. 355; Comrs. *v.* January, 94 U. S. 202; San Antonio *v.* Mehaffy, 96 U. S. 312; County of Warren *v.* Marcy, 97 U. S. 96. So, if a cashier has authority to certify a check, the bank is estopped to say that his authority is false in fact. Merchants' Bank *v.* State Bank, 10 Wall. 604. If a company has issued a certificate of shares, it is estopped to prove against one who has bought the shares in good faith, or even one who has paid one call or assessment to a third person on the strength of the certificate, that it was issued improvidently. In re Bahia, etc., Co., L. R., 3 Q. B. 584; Hart *v.* Frontino, etc., Co., L. R., 5 Exch. 111. Where the president, who was also transfer agent of a railroad company, issued an immense amount of false and fraudulent certificates of shares, beyond the whole capital, the company, after 'a decade of litigation,' was held bound to indemnify the honest purchasers. New York & New Haven R. R. Co. *v.* Schuyler, 34 N. Y. 30."

[1] Atlantic Cotton Mills *v.* Indian Orchard Mills, (1888) 147 Mass. 268. C. ALLEN, J., speaking for the court said: "The ground on which the plaintiff asserts a right to retain the money is, that [its treasurer] had embezzled its funds, as well as the funds of the defendant, to a large amount, and that it is entitled to apply the money thus received from him to reduce his indebtedness for such embezzlements, and treat the same as a payment *pro tanto;* that from the nature of the transaction the law stamps it as a payment, and that thus the plaintiff is a holder of the funds for a valuable consideration. There is no doubt that a thief may use stolen money or stolen negotiable securities before their maturity, to pay his debts, and in such case an innocent creditor may retain the payment. But this doctrine is inapplicable to the present case for two reasons: In the first place, under the circumstances disclosed in the auditor's report, the plaintiff cannot be considered as an innocent creditor, that is, a creditor without notice, and, moreover, the transaction did not amount to payment. It is true that no officer of the plaintiff besides [its treasurer] knew of the fraudulent origin of these checks; but in the very transaction of receiving them, the plaintiff was represented by [him] and by him alone, and is bound by his knowledge. It is the same as if the plaintiff's directors had received the checks, knowing what he knew. For the purpose of accepting the checks, [he] stood in the place of the plaintiff, and was the plaintiff. It is quite immaterial, in reference to this question, in what manner or by what officer of the corporation the funds were received. The important consideration

§ 218. When a corporation must respond for damages resulting from a fraudulent issue of its stock.— One who was the secretary, treasurer and transfer agent of a domestic corporation, a street railroad company of the city of New York, and, as such secretary, kept and had in his custody the books of the corporation relating to the issue and transfer of stock, filled out a blank certificate taken from the company's certificate book, forged the name of its president thereto, signed his own name as treasurer, then countersigned it and impressed thereon the corporate seal. The by-laws of the corporation required that "all certificates shall be issued and signed by the president and treasurer and countersigned by the transfer agent." The certificate upon its face was perfect and regular in every respect, and showed a partner of the secretary and treasurer to be the owner of the shares of stock stated therein. The *in testimonium* clause recited that the corporation had caused the certificate to be signed by its president and countersigned by its treasurer and transfer agent, and sealed with its corporate seal. The partner of this officer of the corporation procured of a bank a loan upon his note secured by a pledge of the certificate. Before acting upon the applica-

is how the plaintiff became possessed of the money, and it is apparent that it was through the act of no other person than of [the treasurer] himself. It is not as if he had stolen the money, and then called the directors of the plaintiff corporation together and informed them of his indebtedness and of his desire to make a payment on account, and had then paid over to them the money as money coming from himself, and they had received it without knowledge or suspicion that it had been stolen, and given him credit for it as part payment. There was no transaction, whatever, between [the treasurer] and the plaintiff, in respect to the transfer of this money, in which the plaintiff was represented either in whole or in part by any other person than by [him], and, therefore, even though the transfer to the plaintiff had been made in bank bills or in gold coin (which it was not), the plaintiff must be deemed to have had knowledge of the true ownership, because in receiving the funds it acted solely through [his] agency. It must be deemed to have known what he knew, and it cannot retain the benefits of his acts, without accepting the consequences of his knowledge. The plaintiff cannot obtain greater rights from his act than if it did the thing itself, knowing what he knew. Such is the doctrine either expressly declared or necessarily involved in numerous adjudged cases. The leading case in this commonwealth is Atlantic Bank *v.* Merchants' Bank, 10 Gray, 532, where there was the semblance of an accounting between the guilty agent and other officers of the bank which received the money, but it was held that there was no real accounting and the general principle was held to be applicable. That case was followed by Skinner *v.* Merchants' Bank, 4 Allen, 290, where the facts were similar." After reviewing and citing many cases, it is further on in the opinion said: "We have preferred to put the decision of this point upon the broad ground that, if the treasurer of a corporation is a defaulter, and his defalcation is as yet unknown and unsuspected, and he steals money from a third person and places it with the funds of the corporation in order to conceal and make good his defalcation, and the corporation uses the money as its own, no other officer knowing any of the facts, the corporation does not thereby acquire a good title to the money, as against the true owner, but the latter may maintain an action against the corporation to recover back the same. But it is also apparent that in the present case the decision might rest upon a narrower ground. The fraudulent transfers were made by checks of the defendant, payable to the order of the plaintiff, and these checks before being available must necessarily have been indorsed by the plaintiff, acting by some officer authorized to indorse checks payable to its order. If these checks, therefore, were taken by the plaintiff in payment of indebtedness of [the treasurer] they carried notice upon their face that they were checks of the defendant, not payable to [his] order but to the order of the plaintiff. Now, assuming that [his] transaction had been conducted with some other officers of the plaintiff, who represented that corporation, it is impossible to suppose that they could have accepted these checks in extinguishment of a known indebtedness of [the treasurer] without being put upon inquiry as to how he came by the defendant's checks to so large an amount, made payable to the plaintiff, which he could apply upon his private account. National Bank of North America *v.* Bangs, 106 Mass. 441, 445." After commenting upon various cases cited by the plaintiff's counsel the discussion of this point closes with this: "Thus far the discussion has proceeded upon the assumption that even if the transfer of the defendant's property to the plaintiff were intended as a payment on account of [the treasurer's] indebtedness to the plaintiff, yet the plaintiff would not be entitled to hold the same on the ground that it would be chargeable with [his] knowledge of the source from which the money came. But it is equally clear that the transfer cannot be considered as a payment by [him] to the plaintiff, because it was not so understood. Nobody on the part of the plaintiff called [the treasurer] to any account, or knew that he was accounting or that he was indebted to the plaintiff, or that these funds had come into the plaintiff's possession or that they had come from [the treasurer]. Nobody but [he] could possibly have intended that the transaction should amount to a payment, and his intention, if entertained, was ineffectual because of his fraud. It is not necessary to deny or doubt that [he] might secretly transfer to the treasury of the corporation money or property of his own, and thus, if the same should be kept, extinguish an indebtedness arising from a former embezzlement. There would be nothing fraudulent in the act of such a transfer; and the corporation, being lawfully in possession of the money or property, might properly keep it. But where he undertook in this manner to make a payment by secretly transferring the property of a third person the act cannot take effect as a payment, because it was not received as such by any person acting in behalf of the plaintiff. There was not even the semblance of an accounting. And under these circumstances if the plaintiff would adopt the intention to make it a payment it must also adopt the fraud. It cannot adopt so much

tion for a loan the bank sent a clerk with the certificate to the office of the corporation, who showed it to the secretary, who was in charge of the office, who, in response to inquiries, stated that the certificate was genuine and all right, and that the applicant for the loan was a stockholder, and, relying thereon, the bank discounted the note. The bank afterwards was compelled to sell the certificate held as collateral to a *bona fide* purchaser, and when he presented it to the proper officers of the corporation for a transfer the corporation refused to recognize the certificate as valid evidence of title to the shares of stock stated therein. The bank upon this being brought to its knowledge, refunded the purchase money, and had the purchaser reassign the certificate to the bank, and brought its action against the corporation for damages incurred by its refusal to recognize the certificate, its right of recovery being based upon the corporation's liability on account of the fraud of its officer. The New York Court of Appeals declared these general rules, that where a certificate of stock contained apparently all the essentials of genuineness a *bona fide* holder thereof was entitled to recognition as a stockholder, if a new certificate could be issued to him, or to indemnity, if this could not be done; that the fact that an official signature to the certificate had been forged did not extinguish this right where the forgery had been done by, or at the instance of, an officer of the corporation intrusted with the custody of its stock books, and held out by the company as the source of information on that subject; that while certificates of stock in railroad and other business corporations do not possess in full the qualities of commercial paper, when the transfer indorsed thereon is signed in blank by the stockholder named therein, they become in effect, so far as the public is concerned, the same as if they had been issued to bearer.[1] It appeared in a

of [the treasurer's] act as was beneficial and reject the rest. As Lord Kenyon said in Smith *v.* Hodson, 4 T. R. 211, it cannot blow hot and cold. This ground also is fully covered by the decisions in Atlantic Bank *v.* Merchants' Bank, 10 Gray, 532, 547–553, and in Skinner *v.* Merchants' Bank, 4 Allen, 290."

[1] Fifth Avenue Bank of New York *v.* Forty-second Street & Grand Street Ferry R. R. Co., (1893) 137 N. Y. 231; s. c., 33 N. E. Rep. 378, affirming judgment in favor of the bank. Referring to the ruling of the court that the corporation, in this case, was liable on account of the acts of its officer, the court, speaking through Maynard, J., said: "This result follows from the application of the fundamental rules which determine the obligations of a principal for the acts of its agent. They are embraced in the comprehensive statement of Story

New York case that the by-laws of the corporation required certificates of stock to be issued under the corporate seal and signed by the president and treasurer. The treasurer, upon the faith and pledge as collateral of spurious certificates of its stock, drawn up and executed in the form and manner prescribed by the by-laws (the signature of the president having been negligently affixed), purporting on their face to be of stock owned by the treasurer,

in his work on Agency (9th ed. § 452), that the principal is to be 'held liable to third persons in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligences and other malfeasances, or misfeasances and omissions of duty of his agent in the course of his employment, although the principal did not authorize, or justify, or participate in, or, indeed, know of such misconduct, or even if he forbade the acts or disapproved of them. In all such cases the rule applies *respondeat superior*, and is founded upon public policy and convenience, for in no other way could there be any safety to third persons in their dealings, either directly with the principal, or indirectly with him through the instrumentality of agents. In every such case the principal holds out his agent as competent and fit to be trusted, and thereby, in effect, he warrants his fidelity and good conduct in all matters within the scope of his agency.' It is true that the secretary and transfer agent had no authority to issue a certificate of stock except upon the surrender and cancellation of a previously existing valid certificate, and the signature of the president and treasurer first obtained to the certificate to be issued; but these were facts necessarily and peculiarily within the knowledge of the secretary, and the issue of the certificate in due form was a representation by the secretary and transfer agent that these conditions had been complied with, and that the facts existed upon which his rights to act depended. It was a certificate apparently made in the course of his employment, as the agent of the company, and within the scope of the general authority conferred upon him, and the [corporation] is under an implied obligation to make indemnity to the plaintiff for the loss sustained by the negligent or wrongful exercise by its officers of the general powers conferred upon them. Griswold *v.* Haven, 25 N. Y. 599; New York & New Haven R. R. Co. *v.* Schuyler, 34 N. Y. 30; Titus *v.* G. W. Turnpike Co., 61 N. Y. 237; Bank of Batavia *v.* New York, L. E. & W. R. R. Co., 106 N. Y. 199." It was said further in this opinion: "The learned counsel for the defendant seeks to distinguish this case from the authorities cited, because the signature of the president to the certificate was not genuine; but we cannot see how the forgery of the name of the president can relieve the defendant from liability for the fraudulent acts of its secretary, treasurer and transfer agent. They were officers to whom it had intrusted the authority to make the final declaration as to the validity of the shares of stock it might issue, and where their acts, in the apparent exercise of this power, are accompanied with all the indicia of genuineness, it is essential to the public welfare that the principal should be responsible to all persons who receive the certificates in good faith and for a valuable consideration and in the ordinary course of business whether the indicia are true or not. 2 Beach on Pr. Corp.

obtained a loan of one acting in good faith and in ignorance of the fraud. The Court of Appeals held that there was nothing upon the face of the certificate to notify the lender of any defect in the title of the treasurer to these shares, and that the corporation was liable to him for the damages.[1]

§ 219. The same subject — Massachusetts decisions. — Several cases have been adjudicated by the Supreme Court of Judicature of Massachusetts, growing out of the fraudulent transactions of a treasurer of a railroad corporation of that state. The facts were that he was supplied by the president with blank certificates of its stock, signed by the president. The treasurer was also a stockbroker. In this latter capacity he told a customer on one occasion, that he had purchased shares of this stock for her as ordered, and she paid him for it. On another occasion he ordered certain brokers to sell shares of the stock for him, and they did so, and received payment for it. He owned no stock, and held none as agent or otherwise, and the whole amount of the capital stock had already been issued. In each case he fraudulently made a fictitious transfer of stock on the books of the corporation, in one case from himself as agent to his customer, and in the other from himself as agent to the brokers, and by means of a blank power of attorney furnished by the brokers and delivered to him, made a further transfer as their attorney to their customers. He then filled out blank certificates of the shares in the usual form under the corporate seal, and delivered

790; North River Bank *v.* Aymar, 3 Hill, 262; Jarvis *v.* Manhattan Beach Co., 53 Hun, 362; Tome *v.* Parkersburg Branch, 39 Md. 36; Baltimore, etc., R. R. Co. *v.* Wilkens, 44 Md. 11, 28; Western M. R. Co. *v.* Franklin Bank, 60 Md. 36; Com. *v.* Bank, 137 Mass. 431; Holden *v.* Phelps, 141 Mass. 456; Manhattan Beach Co. *v.* Harned, 27 Fed. Rep. 486; Shaw *v.* Port Philip & Colonial Gold Mining Co, 13 Q. B. Div. 103. The rule is, we think, correctly stated in Beach on Private Corporations (Vol. 2, § 488, p. 791): 'When certificates of stock contain apparently all the essentials of genuineness, a *bona fide* holder thereof has a claim to recognition as a stockholder, if such stock can be legally issued, or to indemnity if this cannot be done. The fact of forgery does not extinguish his right when it has been perpetrated by or at the instance of an officer placed in authority by the corporation and intrusted with the custody of its stock books and held out by the company as the source of information upon the subject.'"

[1] Titus *v.* President, etc., Great Western Turnpike Road, (1876) 61 N. Y. 237. Claflin *v.* Farmers & Citizens' Bank, 25 N. Y. 293, was distinguished by the Court of Appeals.

them to the purchasers, each of whom received dividends regularly until the fraud was discovered, after which the corporation refused to recognize the certificates as valid, or to allow a transfer of the stock. The purchasers and the brokers acted in good faith, and the brokers acted according to the general custom of brokers. The treasurer had made nearly all the transfers on the books of the corporation as attorney under like powers; and it was not the custom of brokers to take transfers of certificates to themselves when ordered to sell stocks. The court upon these agreed facts held that the plaintiffs were entitled to damages from the company, as the company could issue no more stock, and the measure of the damages was the market value of the shares at the time the corporation first refused to recognize the certificates as valid.[1]

[1] Allen *v.* South Boston Railroad Co., (1889) 150 Mass. 200; Craft *v.* South Boston Railroad Co., (1889) 150 Mass. 200. "The agreed facts in both cases," said FIELD, J., speaking for the court, "show gross carelessness on the part of the president in signing certificates in blank, and negligence on the part of the directors in not examining the books and discovering the fictitious transfers of stock made by the treasurer." Then, as to the admissions on the part of the defendant, it is said: "The counsel for the defendant does not deny that if these certificates of stock had been sold and duly assigned by the plaintiffs for value to one who had no knowledge that they had been fraudulently issued, the defendant would be liable in damages to the purchaser. He admits the general rule that a corporation is estopped to deny the validity of certificates issued in proper form under its seal, and duly signed by the officers authorized to issue certificates, if they are held by persons who took them for value without knowledge or notice that they had been fraudulently issued." Moores *v.* Citizens' National Bank, 111 U. S. 156; Boston & Albany Railroad *v.* Richardson, 135 Mass. 473; Machinists' National Bank v. Field, 126 Mass. 345; Pratt v. Taunton Copper Manuf. Co., 123 Mass. 110; New York & New Haven Railroad *v.* Schuyler, 34 N. Y. 30, 64; Titus *v.* Great Western Turnpike Road, 61 N. Y. 237, 245; Holbrook v. New Jersey Zinc Co., 57 N. Y. 616; Shaw *v.* Port Philip Mining Co., 13 Q. B. D. 103. Of the contention on behalf of the corporation, it is said: "But he contends that the plaintiffs were negligent in accepting the new certificates without taking pains to ascertain whether old certificates of a corresponding number of shares had been surrendered, and a transfer made upon the books of the company. Each certificate of stock in the defendant's company, as the plaintiff knew, declared that the shares are 'transferable by an assignment in the books of said company upon a surrender of this certificate. When a transfer shall be made in the books of the company, and this certificate surrendered, a new one will be issued.' See Pub. Sts. Mass. chap. 113, § 13. The contention is, that one object of this provision was the protection of the corporation against the frauds of its officers in issuing false certificates, and that if the plaintiffs in these cases had re-

§ 220. The same subject — a Pennsylvania decision.— A president of a corporation having fraudulently issued false certificates of stock of the corporation, properly signed and sealed, in excess of the amount authorized by law, a Court of

quired that a certificate of shares be delivered to them with an assignment of it, or a power of attorney to assign it, [the treasurer] could not have committed these frauds." The court said to this: "We do not see why [the treasurer], having been intrusted with blank certificates signed by the president, might not have issued certificates to himself, and then assigned them when the stock was sold, and on the surrender of the old certificates have issued new certificates. Perhaps the chances of detection would have been slightly greater if he had proceeded in this way. But certainly this provision regulating the transfer of stock, if intended as a protection to the corporation against the frauds of its officers, is insufficient. The primary purpose of it undoubtedly was to prescribe the manner in which such intangible property as shares of stock should be transferred from one person to another, and it required the transfer to be made on the books of the company that the company might know who its stockholders were, and it required the surrender of the old certificate before the new one was issued, that there might not be two or more certificates outstanding for the same shares of stock. The ground on which a corporation is held liable to a *bona fide* purchaser for value of false certificates of its stock issued under its seal, signed by the proper officers, and apparently genuine, is that the certificates are statements by the corporation of facts which it is its duty to know, and which cannot well be known to the purchaser. It is the duty of the proper officer of the corporation to ascertain that its stock has been transferred in accordance with its by-laws and in accordance with law, before they issue a new certificate. The transfer, which must be made on the books of the company, must be made by the owner of the old certificate, or by his attorney for him. The surrender of the old certificate must be made by him or his attorney. There is no provision that it shall be made by the purchaser, as the assignee of the attorney of the seller. If the seller undertakes with the purchaser to make the surrender and the transfer on the books of the company, the only thing left for the purchaser to do is to call upon the corporation for the new certificate. We see no good reason for holding that there is a duty on the part of the purchaser towards the corporation, to see to it that the seller of stock surrenders his certificate and transfers it on the books of the corporation. That is the duty of the corporation towards both the seller and the purchaser before it issues a new certificate. If the purchaser exhibits to the corporation a forged assignment of stock or a forged power of attorney to assign it, and thus obtains a new certificate, which he sells, he is liable to the corporation, not because it is his duty to attend to the transfer of stock, but because he has impliedly represented the forged signature to be the genuine signature of a stockholder, whereby he has deceived the corporation. Boston & Albany Railroad *v.* Richardson, 135 Mass. 473. Before the passage of the statute of 1884, chapter 229, if not since, the transfer of stock was usually attended to by brokers, if the stock was bought and sold through brokers. Many shares

Common Pleas of Pennsylvania held that *bona fide* purchasers of such stock were entitled to relief against the corporation which could not gainsay its own certificates. They held further that the measure of damages in such a case would be the market value

of stock represented by a single certificate were often sold in parcels to many different persons, and the seller made but one surrender, with powers of attorney to transfer the parcels to the different purchasers. A purchaser of stock violated no duty to the corporation when he trusted to the seller to make the assignment and the surrender of the old certificate. The utmost that can reasonably be contended is that the fact that a certificate was not exhibited and delivered with a power of attorney to the purchaser, was a circumstance to be considered upon the question whether the purchaser acted in good faith and with due care." The court then, in detail, states the facts attending the purchase and transfer of shares through the brokers, and said: "On these facts, we think it clear that [this plaintiff] exercised due care in obtaining a transfer of the stock, and that [the treasurer] in making the transfer was not his agent, but the agent of [the broker selling it], or the undisclosed principal. In issuing the new certificate he was the agent of the defendant, and as the plaintiff cannot now be put *in statu quo*, the defendant must bear the loss." Of the second case, it was said: "The plaintiff received from [the treasurer], as broker, a certificate, in her name, of the stock which he said he had bought for her, and there is nothing to show that this was not the usual way in which brokers transacted such business. Apparently [she] acted as a purchaser, though a broker usually acted, and we see no want of due care on her part." They then refer to a question in her case: "Another question arises in her case from the fact that [the treasurer], who committed the fraud upon the defendant, was, also, her agent in the transaction. If he be regarded as acting in two capacities, and as having committed the fraud in his capacity as treasurer, he yet, as her agent, knew of and participated in it. Is this knowledge to be imputed to her in determining her rights against the defendant? The general rule is that notice to an agent, while acting for his principal, of facts affecting the character of the transaction, is constructive notice to the principal. Suit *v.* Woodhall, 113 Mass. 391; National Security Bank *v.* Cushman, 121 Mass. 490; Sartwell *v.* North, 144 Mass. 188; The Distilled Spirits, 11 Wall. 356. There is an exception to this rule, when the agent is engaged in committing an independent fraudulent act on his own account, and the facts to be imputed relate to this fraudulent act. It is sometimes said that it cannot be presumed that an agent will communicate to his principal acts of fraud which he has committed on his own account in transacting the business of his principal, and that the doctrine of imputed knowledge rests upon a presumption that an agent will communicate to his principal whatever he knows concerning the business he is engaged in transacting as agent. It may be doubted whether the rule and the exception rest on any such reasons. It has been suggested that the true reason for the exception is that an independent fraud committed by an agent on his own account is beyond the scope of his employment, and, therefore, knowledge of it, as matter of law, cannot be imputed to the prin-

of the stock at the date of a demand by the holders for a transfer, or, if no demand were made, at the date of filing the bills; and, where specific performance was impossible, a pecuniary equivalent might be awarded.[1]

cipal, and the principal cannot be held responsible for it. On this view, such a fraud bears some analogy to a tort willfully committed by a servant for his own purposes, and not as a means of performing the business intrusted to him by his master. Whatever the reason may be, the exception is well established. Kennedy *v.* Green, 3 Myl. & K. 699; Espin *v.* Pemberton, 3 De G. & J. 547; Rolland *v.* Hart, L. R., 6 Ch. 678; In re European Bank, L. R., 5 Ch. 358; Cave *v.* Cave, 15 Ch. D. 639; Kettlewell *v.* Watson, 21 Ch. D. 685, 707; Innerarity *v.* Merchants' National Bank, 139 Mass. 332; Dillaway *v.* Butler, 135 Mass. 479; Atlantic Cotton Mills *v.* Indian Orchard Mills, 147 Mass. 268; Howe *v.* Newmarch, 12 Allen, 49. The case [of Craft *v.* South Boston R. R. Co.] seems to me to fall within this exception. Although the fraudulent act of [the treasurer] may not have been committed with the intention of cheating the plaintiff, yet that was its legal effect, and it was a fraudulent act committed by him for his own benefit, the actual effect of which would have been wholly to avoid the transaction if the plaintiff had known of it. The present cases we think fall within the principle that where one of two innocent persons must suffer a loss from the fraud of a third, the loss must be borne by him whose negligence enabled the third person to commit fraud."

[1] Willis *v.* Philadelphia & Darby R. R. Co., (Pa. 1878) 6 W. N. C. 461. The court said: "It is well settled that one who, as a purchaser or lender, gives value on the faith of a certificate of stock, authenticated by the seal of the corporation and the signatures of the proper officers, acquires an equitable title, and may require the corporation to transfer the stock to him or respond in damages for the default. It is not a sufficient answer to such a demand that the certificate was fraudulently issued, because corporations are, not less than natural persons, answerable for the conduct of their agents in the business intrusted to their care. Nor is it necessarily conclusive against such a purchaser that the party from whom he bought was cognizant of, or participated in, the fraud. If a certificate of stock is not a negotiable instrument, it is a written declaration that the holder has a definite share in the capital or profits of the concern, which, though delivered to him, is intended for circulation and virtually addressed to all the world, and third persons who are misled by such an instrument may justly require that the loss shall fall on the corporation and not on them. New York & New Haven R. R. Co. *v.* Schuyler, 34 N. Y. 30, 52, 80; Bank of Kentucky *v.* Schuylkill Bank, 1 Parsons' Eq. 180; In re Bahia & San Francisco R. R. Co., L. R., 3 Q. B. 595. * * *" The defendants answered that, however sound the argument might be under other circumstances, it was inapplicable here, because the railway company was limited by its charter to ten thousand shares. When that number was reached the power was exhausted, and any subsequent proceedings under it merely void. The barrier thus set was insuperable, and could not have been surmounted by a vote of the directors or stockholders, or by both conjoined. To hold that the president and treas-

§ 221. When a corporation may not respond for damages for fraudulent issue of stock.— The officer of a corporation in a New York case obtained certain certificates of stock of a corporation, which had been signed by a former president of the corporation in blank, and left with the other then officers

urer could, by a fraudulent and unauthorized overissue, bind the company to that which the company was powerless to perform, was to hold that an agent might acquire a power through fraud which the principal did not possess and could not have conferred. The court said: "This argument might be unanswerable if the power to give certificates was identical with the power to create stock, or if a certificate could not legitimately be issued to any one who claimed under a derivative title, because it would then be incumbent on third persons to take notice of the limited nature of the power and ascertain whether it had been strictly pursued. It is, however, plain that the legislature did not intend to impose a rule contrary to the ordinary course of business, and which would have enhanced the market value of the stock. Although the company could not issue a larger number of shares than that prescribed by its charter, it might well give a new certificate to a purchaser in lieu of that surrendered by the vendor, and repeat the act as often as the occason required. This was virtually conceded during the argument, but it was at the same time strenuously urged that, to render such a substitution valid, the pre-existing certificate must be given up as other stock duly transferred on the corporate books. If this method was observed the public and stockholders would be safe, and a departure from it involved an excess of power which rendered the transaction void, not only between the original parties, but as it regarded purchasers claiming under them. The cogency of this reasoning should not render us unmindful of a consideration by which it is controlled. That which a corporation is not authorized to do under any circumstances, or which is absolutely forbidden by its charter, is so entirely void that nothing short of an act of assembly can render it valid, but that which it may do for certain purposes and not for others, or on the happening of a particular event, is not necessarily within this rule, and may take effect although the prerequisites were not fulfilled. N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30, 68. The case in hand apparently belongs to the latter category. We have seen that although the railway company could not create new stock, it might properly give a certificate to a purchaser as evidence that he had acquired a title regularly deduced on the books, and the legal, as well as the natural, presumption in every such case is that the power has been exercised for a legitimate end, and not in a way to render it invalid. N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30, 63. 'Acts of corporations,' says Judge KING in Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. 252, 'which presuppose the existence of other acts to make them legally operative, are presumptive proof of the latter. In short, the acts of artificial persons afford the same presumptions as the acts of natural persons. Each afford presumptions, from acts done, of what preceded. A vote of a corporation may be presumed from other acts, though there is no proof of such vote on the corporate records. * * * The source from which these prin-

to be used in case a stockholder desired to transfer his stock in the president's absence. He filled out the blanks in one of these certificates, inserting his own name as stockholder, forging the name of one who was the treasurer of the corporation when the president signed them, and signed his own name as transfer agent, which position he occupied at that date, and dating the transaction to make it conform to the date when the president's signature was affixed. When he did this he was president of the company. He used the false certificate of stock by pledging it as a collateral security for a loan made to him personally. In an action by the holder of this certificate against the corporation for damages, by reason of his fraud, the New York Court of Appeals held that there could be no recovery.[1]

ciples have been drawn is the judgment of Justice STORY in The Bank *v.* Dandridge, 12 Wheat. 64.' This citation would seem to be a conclusive answer to the argument that the production of a certificate of stock is not *prima facie* evidence of a title, and that a purchaser must examine the records of the corporation and ascertain from them whether the vendor has the right which the certificate avers. Such an investigation is absolutely superfluous where the officers of the corporation have done their duty, and will generally be unavailing when they are engaged in the perpetration of a fraud. N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30, 71. It is no doubt true, as the counsel for the defense contend, that the formal mode of deducing title to stock is by a transfer regularly made in some book kept for the purpose by the corporation or its duly constituted agents. But although a certificate of stock is not the title, it is an authoritative declaration that such a title exists, which may operate as an equitable estoppel in favor of third persons who part with value in the belief that it is true. The legal title does not pass to the purchaser, but he acquires an equitable right, and may insist that the corporation shall transfer the stock, or, if unable to do so in consequence of an obstacle which cannot be removed, give an equivalent for that which is withheld. N. Y. & N. H. R. R. Co. v. Schuyler, 34 N. Y. 30, 80, 83."

[1] Manhattan Life Insurance Co. *v.* Forty-second Street & Grand Street Ferry R. R. Co., (1893) 139 N. Y. 146; s. c., 34 N. E. Rep. 776. This opinion was rendered by MAYNARD, J., who said: "The rule which imposes a liability upon the principal for the unauthorized acts of his agent, is founded upon public policy, and is well defined. It is limited to cases where there was an apparent authority to do the act in question; and it appeared to have been done in the course of his employment as agent and was within the scope of his general powers. None of these grounds of liability have been shown here. The agency did not exist in 1888, which was necessary in order to deprive the principal of the right to disclaim responsibility for the unauthorized act. With respect to the creation of certificates bearing date in 1881, he was as destitute of authority as if he had been a stranger to the corporation. He not only could not issue them, but

§ 222. Massachusetts decisions on this subject.— In a case in Massachusetts it appeared that the treasurer of a railroad corporation had for a private debt placed fraudulently issued stock with his creditor as security in the creditor's name and the creditor had afterwards used it as a collateral himself for a loan, but upon payment of his loan it was reassigned to him. The court held to this effect: That if an officer of a corporation having the

he could take no part in their issue, or do any act required by law, or by the by-laws, essential to give them validity. When he issued such a certificate in his own name, he was not apparently acting within the scope of any general authority conferred upon him by the corporation. The defendant cannot justly be held liable for the misuse of a power which it never created. This case has no feature in common with the Fifth Avenue Bank against the same defendant, 137 N. Y. 231. There [this officer], at a time when he was treasurer and transfer agent, and invested with authority in both capacities to sign, countersign and seal valid certificates of stock, forged the name of the president to a certificate and issued it to a confederate, who negotiated a loan upon it at the bank, which, before receiving it, caused inquiry to be made at the office of the defendant, and was informed that the certificate was genuine. [He] was there acting within the scope of his apparent authority, and whether the certificate had been actually signed by the president and was issued in the regular course of the administration of the affairs of the company, were facts peculiarly within his knowledge, and the countersigning and issue of the certificate in due form was a representation by him that these conditions had been complied with, and that the facts existed, upon which his right to act depended. Here there was a total lack of delegated power to [him] to do a single lawful act in the issue of the certificate in the form in which it was presented to the plaintiff. There was no negligent or wrongful use by him of any authority derived from the [corporation]. It was a willful and criminal act, perpetrated for private gain and not connected with the exercise of any official authority or semblance of authority which he possessed as the [corporation's] agent. The plaintiff insists that there is another ground upon which a recovery is permissible. When [this officer] made the loan and pledged the forged certificate, he represented to the plaintiff that it was a genuine certificate of the stock of the corporation; and as he was then its president and chief administrative officer, the claim is made that the [corporation] is bound by his representations. * * * [This officer], when he negotiated the loan, was not engaged in the transaction of the [corporation's] business, or in the discharge of any duty imposed upon him by the [corporation]. The declarations of an agent are only admissible against his principal when made as a part of a transaction undertaken in behalf of his principal, or in the performance of the duties of his agency. First Nat. Bk. of Lyons *v.* Ocean Nat. Bk., 60 N. Y. 278. Or, as is sometimes stated, the representations of the agent, when not expressly authorized by the principal, must, in order to bind him, be within the scope of his

power, either alone or with others, to issue certificates of stock, fraudulently issues as security for his private debt a certificate to his creditor in the latter's name, such creditor cannot rely upon the certificate and recover damages from the corporation upon its refusal to recognize it as valid, although he has no knowledge of the fraud; but if upon taking it he fails to investigate the title to the stock he is affected with notice of whatever he might have discovered upon making proper inquiry.[1]

agency, which is but another form of expressing the same proposition. N. Y. Life Ins. Co. *v.* Beebe, 7 N. Y. 364. But, without determining what are the duties of the officers of a corporation, when called upon to respond to the inquiries of intending purchasers of the stock, there is a sufficient reason why the plaintiff cannot avail himself of the representations of [this officer] in regard to the genuineness of this certificate. They were made in a private and personal transaction, undertaken for his individual benefit and so understood by the plaintiff. The plaintiff knew that [this officer], in the negotiation of the loan, was not acting as the officer or agent of the [corporation], or in its behalf, and that his personal interest in the transaction might lead him to betray his principal. It is an old doctrine, from which there has never been any departure, that an agent cannot bind his principal even in matters touching his agency, where he is known to be acting for himself, or to have an adverse interest." See, also, Stone *v.* Hayes, 3 Denio, 575; Bentley *v.* Columbia Ins. Co., 17 N. Y. 423; Claflin *v.* Farmers & Citizens' Bank, 25 N. Y. 293; Wilson *v.* M. E. R. Co., 120 N. Y. 145; Moores *v.* Citizens' Nat. Bank, 111 U. S. 156; Farrington *v.* South Boston R. R. Co., 150 Mass. 406.

[1] Farrington *v.* South Boston Railroad Company, (1890) 150 Mass. 406. *Arguendo*, it was said: "The present case cannot be distinguished in principle from Moores *v.* Citizens' National Bank, 111 U. S. 156. In that case Mr. Justice BRADLEY dissented, and the decision has been the subject of some criticism. Lowell Transfer of Stock, § 112, note 2. The ground of that decision as stated in the opinion is as follows: The plaintiff 'having distinct notice that the surrender and transfer of a former certificate were prerequisites to the lawful issue of a new one, and having accepted a certificate that she owned stock without taking any steps to assure herself that the legal prerequisites to the validity of her certificate which were to be fulfilled by the former owner and not by the bank had been complied with, she does not, as against the bank, stand in the position of one who receives a certificate of stock from the proper officers without notice of any facts impairing its validity.' Upon a review of the authorities in the opinion it is said: 'This review of the cases shows that there is no precedent for holding that the plaintiff, having dealt with the cashier individually and lent money to him for his private use, and received from him a certificate in her own name, which stated that shares were transferable only on the books of the bank and on surrendered former certificates, and no certificate having been surrendered by him or by her, and there being no evidence of the bank having ratified or received any benefit from the transaction, can recover from the bank the value of the certificate delivered to her by its cashier.' In that case the president of the bank had left blank certificates of stock signed by him with the cashier, as in the present case the president of the railroad company had left similar blank certificates with the treasurer. At the trial of that case in the United States Circuit Court a verdict was directed for the defendant on the ground that the plaintiff having had knowledge of the fact that Moores, upon whom she relied to have the stock transferred to her, was acting for himself as well as in his capacity of cashier — that is, acting for the bank upon one side and for himself on the other in reference to the matter of issuing this certificate — she is not, in the judgment of this court, an innocent holder of the stock. Moores *v.* Citizens' National Bank, 15 Fed. Rep. 141." The Massachusetts Supreme Court resumed: "We have decided in Allen *v.* South Boston Railroad Co., 150 Mass. 200, 204, that a purchaser of stock owes no positive duty to the corporation to see to it that the seller surrenders the old certificate and makes an assignment of the stock on the books of the company, but that it is the duty of the corporation which requires these things to be done to see that they are done before a new certificate is issued to the purchaser. The plaintiff, in the case at bar, knew that he was dealing with the treasurer of the defendant in his personal capacity as a borrower of money. If the by-laws of the company had provided that certificates of stock should be signed only by the treasurer, and if he were charged with the duty of attending to the transfer of stock and the issuing of certificates, any person lending money to him for his private use and taking in his own name a certificate of the company's stock as collateral security, could reasonably be required to investigate the title of the treasurer to the certificate delivered, because in issuing such a certificate the treasurer would have a personal interest adverse to that of the corporation. An agent cannot properly act for his principal and himself when their interests are adverse, and any person dealing with an agent in a matter affecting his principal and knowing that the interests of the agent are adverse to those of his principal, ought to be held to the duty of ascertaining that the acts of the agent are authorized by his principal. The difficulty in the present case is that these considerations are only partially applicable to it. It is on account of the danger that one officer may abuse his power to issue stock certificates that the by-laws of corporations usually require the certificates to be signed by at least two officers of the corporation. If one of these neglects his duty or delegates the performance of it to the other, the safeguard intended by this requirement of the by-law becomes ineffectual, and if one of these officers in issuing a stock certificate has a personal interest adverse to that of the corporation, a person dealing with him and knowing this may well be required

These facts appear in another Massachusetts case. The by-laws of a corporation provided that "each stockholder shall be entitled to a certificate of his stock under the seal of the corporation and signed by its president and treasurer." The president had no authority to issue certificates of stock. He had access to the stock book and issued to certain parties certificates of shares of the corporation, signed by himself, and forged the signature of the

treasurer to the same. The holders of these certificates sought by action to hold the corporation responsible for these spurious certificates of stock, contending that the corporation was bound to make the certificates good, or was responsible for their being bad, on the ground that, in view of his previous known misconduct, the corporation was negligent in permitting its president to remain in that official position, and to have control of its certificate book and seal, and that the cases fall within the principle that, where one of two innocent persons must suffer a loss for the fraud of a third, the loss must be borne by the one whose negligence enabled the third person to commit the fraud. The Supreme Court of Judicature of that state held that the corporation was not liable for the acts of its president in issuing these certificates.[1]

to take notice that the rights of the corporation are not protected in the transaction to the full extent intended by the by-laws."

[1] Hill *v.* C. F. Jewett Publishing Co., (1891) 154 Mass. 172; s. c., 28 N. E. Rep. 142. ALLEN, J., said: "In the absence of any previous misconduct on [the president's part], it could hardly be maintained that there was any negligence on the part of the corporation in keeping its seal and book of certificates of shares where the president could have access to them, so as to be able to remove blank certificates from the end of the book and impress the corporate seal upon them. We are not aware that it is customary for corporations in this country to keep their seals or books of certificates in such a way that access can only be had to them when two or more officers are present. The chief safeguard in respect to the certificates is the necessity of two signatures. And, accordingly, when one who has had confidence reposed in him has availed himself of his opportunity to commit a fraud upon others by means of forgery, it has usually been held in England that the loss was not a natural or probable result of the confidence thus imposed, even though it showed carelessness, and that it was too remote to be properly chargeable upon those who were thus careless in reposing the confidence. Bank of Ireland *v.* Evans' Charities, 5 H. L. Cas. 389; Mayor etc., of Staple of England *v.* Governor etc., of Bank of England, 21 Q. B. D. 160, 176; Swan *v.* North British Australasian Co., 2 H. & C. 175, 189. See, also, Vagliano *v.* Bank of England, 22 Q. B. D. 103, 117; s. c., on appeal, 23 Q. B. D. 243, 255, 263. The plaintiffs rely much on Shaw *v.* Port Philip & Colonial Gold Mining Co., 13 Q. B. D. 103, which in many of its general features much resembles the present case, but with certain differences. In that case the secretary of the defendant company issued a certificate of shares, with the name of a director forged by himself. The person to whom it was issued bought shares on the market, through a broker, who received a transfer signed by the secretary, accompanied by what purported and in all respects appeared to be a regularly issued certificate of those shares. These were deposited at the company's office, with the request for the issue of a new certificate, in the usual way. The new certificate was issued in the usual form by the secretary, but the signature of a director, which

was required, was forged. It was a part of the regular and authorized duty of the secretary to receive and examine transfers and certificates of shares, to have transfers registered, to procure the preparation, execution and signature of certificates with all requisite and prescribed penalties, and thereupon to issue them to the persons entitled to receive them. Moreover, the company, after the issue of the certificate, paid a dividend thereon, by check signed by the secretary and two directors. The decision of the case, which was not heard before the Court of Appeal, was placed on the ground that the company had made it the duty of the secretary to procure the preparation, execution and signature of certificates with the prescribed penalties, and thereupon to issue them to the person entitled to receive them. The principal facts upon which the decision turned are wanting in the case before us. The president of the defendant corporation was not the proper officer to issue certificates, and the certificates which the plaintiff received did not come from the office of the defendant in the regular course of business, but they were received by the plaintiffs under private and personal transactions between themselves and Jewett, the president."

CHAPTER VI.

PERSONAL LIABILITY OF OFFICERS.

§ 223. Directors' liability — general rules.
224. Liability of other officers — general rules.
225. Rules as to liability of officers for diversion of property of corporation.
226. Liability of officers arising from manner of execution of commercial paper.
227. Liability of officers arising from indorsement of commercial paper.
228. Liability of officers of savings banks.
229. Liability of a treasurer of a corporation for payment of orders on forged indorsements.
230. Liability on contract made before complete organization of the corporation.
231. Rule as to recovery in such a case.
232. County treasurer liable upon his receipts to collector for money.
233. County treasurer liable as bailee of county funds.
234. County treasurer paying court orders on forged instruments.
235. Arbitration as to liability of a treasurer of a township.
236. Liability under special provisions of charter or statute.
237. Liability under provisions of charter — Pennsylvania.
238. Statutory liability — California statutes.
§ 239. Statutory liability — Colorado statutes.
240. Statutory liability — Iowa statutes.
241. Statutory liability — Massachusetts statutes.
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243. Statutory liability — Missouri statutes.
244. Statute of New York — liability for failure to file annual report.
245. Actions to enforce this liability.
246. What are, and what are not, "debts" for which liability under this statute may arise.
247. A United States Supreme Court decision on this subject.
248. Statute of New York — liability for creation of debts in excess of capital stock.
249. Liability for incurring indebtedness in excess of capital stock — Illinois statute.
250. United States Supreme Court decision on a similar statute — the proper action in such a case.
251. New York statute — liability for false statement in certificate, etc., filed.
252. Illustrations.
253. Statutory liability — Rhode Island statutes.
254. Statutory liability — various states.
255. Liability of directors or officers under an English statute.

§ 223. Directors' liability — general rules.— Whether directors of a corporation are to be regarded as its agents or its elements, impartial justice and public policy require that as all natural persons are, so they should be held responsible to third persons for the malfeasance by them in fact committed or commanded.[1] Directors or officers of a corporation acting beyond their power, whereby loss inures to the corporation, or disposing of its property, or paying away its money without authority, will be required to make good the loss out of their private estates.[2] But they are not liable, in the absence of fraud or intentional breach of trust, for negligence, mistakes of judgment and bad management in making investments on doubtful or insufficient security. Where they have not profited personally by bad management or appropriated any of the property of the corporation to their own use, courts of equity treat them with indulgence.[3] The directors of a corporation, as trustees of its shareholders, are liable for all losses caused by their willful failure to exercise the care and attention to the affairs of the corporation which would prevent a misappropriation of the trust or corporate funds.[4] But directors and officers of a company will not be held personally liable to its creditors on the ground that they have mismanaged its business and contracted an indebtedness in excess of the limit prescribed in its charter, unless they are made liable by the provisions of the charter or some general statute regulating such corporations. And it would make no difference that the credit be extended in reliance upon the business character and financial responsibility of the directors and officers.[5] If directors of a cor-

[1] Rule declared in Salmon *v.* Richardson, (1862) 30 Conn. 360, 374, in which case the directors of an insurance company who had fraudulently permitted false statements to be officially made by the president and secretary of the company, as to its assets and condition, which induced a person to insure in the company when the company was utterly insolvent, and after his loss he could recover nothing from the company, were held not to be saved from personal liability for the injury by reason of the fact that they were acting officially.

[2] Joint-Stock Discount Co. *v.* Brown, L. R., 8 Eq. 381; Flitcroft's Case, L. R., 21 Ch. Div. 519; Franklin Ins. Co. *v.* Jenkins, 3 Wend. 130.

[3] Briggs *v.* Spaulding, 141 U. S. 136; Spering's Appeal, 71 Pa. St. 11; Citizens' B. L. & S. Association *v.* Coriell, 34 N. J. Eq. 383, 392; Swentzel *v.* Penn. Bank, (1891) 147 Pa. St. 140; s. c., 23 Atl. Rep. 413; In re Forest of Dean Coal Mining Co., L. R., 10 Ch. Div. 450; Ackerman *v.* Halsey, 37 N. J. Eq. 363; Hun *v.* Cary, 82 N. Y. 65; In re Denham & Co., L. R., 25 Ch. Div. 752; Watts' Appeal, 78 Pa. St. 391. Liability of directors for acts *ultra vires* discussed, and decisions showing the current of authority in England on the subject reviewed, 34 Solic. J. 503.

[4] Lewis *v.* St. Albans Iron & Steel Works, 50 Vt. 477.

[5] Frost Manufacturing Co. *v.* Foster, (1889) 76 Iowa, 535; s. c., 41 N. W. Rep. 212. That directors are not re-

poration are guilty of gross negligence and inattention to the duties of their trust, they will be personally liable if they suffer the corporate funds or property to be wasted or lost by reason of such negligence and inattention.[1] The care and diligence required of directors in the discharge of their duties as such, must be determined in each case in view of all the circumstances.[2] The directors of a corporation in whom its constitution reposes an enlarged discretion in the management of its business, are responsible to its stockholders only for good faith and reasonable diligence; a mere error of judgment on their part in compromising a debt due to the corporation, would not entitle a stockholder to relief against the directors in equity.[3] The directors of a manufacturing corporation have no authority to divert the corporate property by issuing accommodation paper, or otherwise loaning its money or credit without consideration.[4] And where officers of such a corporation accept accommodation paper in the name of the corporation, they will be held personally responsible to it for payments made or liabilities incurred in consequence of such acceptance on their part in its behalf.[5] A board of directors, in carrying out the vote of the required majority of the board, directing a total cessation of the business of the corporation and a liquidation of its affairs, would be acting within the sphere of its lawful authority and would not be held liable for any loss occurring to the minority from the step they had taken in carrying out

lieved from liability by the fact that they act gratuitously in that capacity, see Donaldson *v.* Haldane, 7 Cl. & Fin. 771; Thorne *v.* Deas, 4 Johns. 84, 96, 97; Charitable Corporation *v.* Sutton, 2 Atk. 405; Litchfield *v.* White, 3 Sandf. 551; Spering's Appeal, 71 Pa. St. 11, 21; Giblin *v.* McMullen, L. R., 2 Privy Council Cas. 318, 337; First Nat. Bank *v.* Ocean Bank, 60 N. Y. 295; Grill *v.* S. C. Co., L. R., 1 C. P. 612; Beal *v.* R. R. Co., 3 Hurlst. & Colt. 341; Nolton *v.* R. R. Co., 15 N. Y. 444; Wilson *v.* Brett, 11 Mees. & W. 113, 115.

[1] Horn Silver Mining Co. *v.* Ryan, (1889) 42 Minn. 196; s. c., 44 N. W. Rep. 56. See, also, Brinkerhoff *v.* Bostwick, 88 N. Y. 52.

[2] Horn Silver Mining Co. *v.* Ryan, (1889) 42 Minn. 196; s. c., 44 N. W. Rep. 56.

[3] Smith *v.* Prattville Manufg. Co., (1857) 29 Ala. 503; citing Angell & Ames on Corp. §§ 312–314; Robinson *v.* Smith, 3 Paige, 222; Forbes *v.* Whitlock, 3 Edw. Ch. 446; Bushwick, etc., Turnpike Co. *v.* Ebbetts, 3 Edw. Ch. 353; Van Cortlandt *v.* Underhill, 17 Johns. 405; Dodge *v.* Woolsey, 18 How. 331; Godbold *v.* Branch Bank at Mobile, 11 Ala. 191; Mozley *v.* Alston, 1 Phil. Ch. 790; Ware *v.* Grand Junction Water Works Co., 2 Russ. & Myl. 470.

[4] Hutchinson *v.* Sutton Manufacturing Co., (1893) 57 Fed. Rep. 998.

[5] Ibid.

the vote of the majority.[1] An action against directors of a corporation for misfeasance or culpable negligence in the discharge of their official duty, may be in form legal or equitable according to the circumstances of the particular case. The proper plaintiff in such a case is the corporation.[2] The complaint in such a case need not negative knowledge of, or acquiescence on the part of the stockholders in the negligence or misconduct of the directors.[3] Where directors waste or misappropriate the funds, or convert assets of the corporation in violation of their trust, or lose them in speculations, a recovery at law may be had against the defaulting directors, while a suit in equity might also be maintained for an accounting, at the election of the corporation.[4] The directors of a corporation which has purchased the franchises and property of another corporation under an agreement that its debts would be paid, misapplying the assets of the latter, and leaving its debts unpaid, will be held individually responsible to the creditors of that corporation to the extent of the assets received and misapplied.[5] Directors of a life insurance company who had transferred its entire stock and assets to another in which its policyholders reinsured their risks, which transaction resulted in great loss to policyholders and creditors of the company, have been held liable to the receiver of the company to the full extent of the damage caused by such misapplication and waste of the company's funds. And the fact that these directors carried out

[1] Trisconi *v.* Winship, (1890) 43 La. Ann. 45; s. c., 9 So. Rep. 29. In Baily, Receiver, *v.* Burgess, (1891) 48 N. J. Eq. 411; s. c., 22 Atl. Rep. 733, a director of a corporation who was appointed as agent to secure a plant of another corporation for its use, and to remove incumbrances from it, and furnished a sum of money for the purpose, was held to account to the receiver of the corporation for the amount not expended by him as well as interest on various sums of money which he could have applied to the removal of incumbrances upon the property, but negligently delayed doing so with the funds in his hands.

[2] Horn Silver Mining Co. *v.* Ryan, (1889) 42 Minn. 196; s. c., 44 N. W. Rep. 56

[2] Ibid. See Rolseth *v.* Smith, 38 Minn. 14; s. c., 35 N. W. Rep. 565.

[4] Franklin Fire Ins. Co. *v.* Jenkins, 3 Wend. 130; Robinson *v.* Smith, 3 Paige, 222.

[5] National Bank of Jefferson *v.* Texas Investment Co. (Lim.), (1889) 74 Tex. 421; s. c., 12 S. W. Rep. 101. In Holt *v.* Bennett, (1888) 146 Mass. 437; s. c., 16 N. E. Rep. 5, it was held that payments made by a corporation intending in good faith to go on and develop valuable patents owned by it, to its directors of money borrowed from them in the ordinary course of business, were not recoverable from such directors by a creditor of the corporation whose debt at the time was not due and payable.

the transactions under the advice of able and experienced counsel was held not to relieve them from their liability; nor did the action of the policyholders in reinsuring their risks in the other company to which the assets were transferred, and receiving, by order of court, dividends upon their policies from the assets of this company, amount to a ratification of the illegal transactions of the directors so as to preclude them or a receiver of the company from maintaining an action against the directors for their misconduct in the matter.[1]

§ 224. Liability of other officers — general rules. — The officers of a corporation are not liable personally, at common law, on a promissory note of the corporation, made by them as such officers, in which the promise to pay is made by the corporation, and not by the officers personally.[2] If any personal liability exists against officers of a corporation who have executed a note binding the corporation by its terms, and not themselves personally, and the contract is made without authority, and the corporation cannot be holden responsible on the contract, the liability results from the wrong done by the officers in undertaking to act without authority.[3] When a corporation has in fact no authority to contract debts, a contract of a debt upon its supposed credit by its officers would impose a personal liability upon them.[4] One, a director, vice-president and general foreman of a corporation, who signed the name of the corporation to an agreement to contribute to the expenses of a suit at law, without informing the other parties of his want of authority to do so, thus giving them to understand that the corporation was interested, was held by the Michigan Supreme Court liable to contribute the share of the expenses otherwise chargeable to the corporation.[5] The president of a corporation may be held individually liable on an implied warranty of his authority where he executes a written guaranty in the name of the corporation without authority.[1] The president of a corporation would not make himself personally liable to a stockholder by a promise upon his transferring the stock he owned to him, that when the corporation was wound up the stockholder should receive the proportion of the proceeds to which he would be entitled.[2] An officer of a corporation, in an action against him to recover moneys wrongfully retained by him belonging to the corporation, cannot defend on the ground that the receipt of such moneys by the corporation was for work or business illegal or *ultra vires* the powers of the corporation, or that its charter was fraudulently obtained and the election of its officers illegal.[3] The president of a bank has been held chargeable with constructive notice of the management of its affairs by the cashier and other subordinate officers; and where the bank was doing business without legal organization he could not escape the responsibility resulting from such notice by showing that he supposed himself the president of a legally constituted bank, if he had contributed the influence of his reputation to give undeserved credit to a spurious corporation.[4] The liability of an ostensible president of a spurious bank, in a depositor's suit for damages, is direct and original, and he will be held responsible in damages to the same extent as the bank, if legally constituted, would have been liable.[5] In a Wisconsin case, seeking to charge certain officers of a corporation individually for negligence in the conduct of its affairs, it appeared that these officers, president, secretary and treasurer, who had been intrusted with the management by the directors, who held no meetings and gave no attention to their duties, had conducted the affairs of the corporation in good faith, though negligently and in the exercise of powers belonging solely to the board of directors. The Supreme Court held that these officers could not be charged as *ex officio* members of the board

[1] Pierson *v.* Cronk, (Sup. Ct. N. Y. Spl. Term, 1890) 26 Abb. N. C. 25; s. c., 13 N. Y. Supp. 845.

[2] Hall *v.* Crandall, (1866) 29 Cal. 567. See, also, Blanchard *v.* Kaull, (1872) 44 Cal. 440; Lander *v.* Castro, 43 Cal. 497.

[3] Hall *v.* Crandall, (1866) 29 Cal. 567.

[4] Drake *v.* Flewellen, 33 Ala. 106; Harwood *v.* Humes, 9 Ala. 659.

[5] Solomon *v.* Penoyar, (1891) 89 Mich. 11; s. c., 50 N. W. Rep. 644. In Vincent *v.* Chapman, 10 G. & J. (Md.) 282, the Maryland Court of Appeals held that there could be imposed no personal responsibility upon the members of the vestry of a church by proceedings as vestrymen pledging the corporate funds to persons who might perform work for it, which the vestry then thought adequate, if the funds should prove to be merely nominal and inadequate; further, that their subsequently manifesting an impression that they had assumed a personal responsibility, without an act to fix the liability, could not vary the interpretation of the instrument nor entitle the pledgers to a recovery upon a claim not otherwise well founded.

[1] Nelligan *v.* Campbell, (1893) 65 Hun, 622; s. c., 20 N. Y. Supp. 234.

[2] Thompson *v.* Stanley, (1893) 20 N. Y. Supp. 317.

[3] Haacke *v.* Knights of Liberty Social & Literary Club, (1892), 76 Md. 429; s. c., 25 Atl. Rep. 422.

[4] Hauser *v.* Tate, (1881) 85 N. C. 81.

[5] Ibid.

of directors, and that neither of them was liable for the negligence or unauthorized acts of the others in which he did not participate.[1] The court also ruled upon some questions of evidence in such a case as follows: That mere proof of failure to collect certain moneys due to the corporation was not proof that such moneys were lost; also, that in respect to losses alleged to have been sustained because of insufficient payments to the corporation on certain accounts, a report of the secretary was not competent evidence against the president and treasurer to charge them with such losses or to show that no more was paid to him than he reported.[2] A corporation obligating itself to aid another in its enterprise, and placing funds in the hands of its treasurer for the purpose of meeting the obligation, cannot hold him liable for the funds where he has expended them in the interest of the other corporation and this expenditure has been assented to by resolution of the corporation's board of directors entered in the records

[1] North Hudson Mutual Building & Loan Association *v.* Childs, (1892) 82 Wis. 460; s. c., 52 N. W. Rep. 600. The Wisconsin Supreme Court declared the rules as to liability of officers in these words: "The liability of officers to the corporation for damages caused by neglect or unauthorized acts rests upon the common-law rule, which renders every agent liable who violates his authority, or neglects his duty to the damage of his principal. It seems to be now universally agreed that, no matter whether the act is prohibited by the charter or by-laws, the liability is on the ground of violation of authority or neglect of duty. Thomp. Liab. Off. Corp. 357; Briggs *v.* Spaulding, 141 U. S. 146. There can be no doubt that if the directors or officers of a company do acts clearly beyond their power, whereby loss ensues to the company, or dispose of its property or pay away its money without authority, they will be required to make good the loss out of their private estates. Thomp. Liab. Off. Corp. 375; Joint-Stock Discount Co. v. Brown, L. R., 8 Eq. 381; Flitcroft's Case, L. R., 21 Ch. Div. 519; Franklin Ins. Co. v. Jenkins, 3 Wend. 130. * * * This is the rule where the disposition made of money or property of the corporation is one either not within the lawful power of the corporation, or, if within the power of the corporation, is not within the power or authority of the particular officer or officers. Where the ground of liability is for nonfeasance, negligence or misjudgment in respect to matters within the scope of the proper powers of the officer, he will be held responsible only for a failure to bring to the discharge of his duties such degree of attention, care, skill and judgment as are ordinarily used and practiced in the discharge of such duties or employments; the degree of care, skill and judgment depending upon the subject to which it is to be applied, the particular circumstances of the case and the usages of business."

[2] North Hudson Mutual Building & Loan Association *v.* Childs, (1892) 82 Wis. 460; s. c., 52 N. W. Rep. 600.

of the corporation.[1] The treasurer of a railroad corporation gave a bond to the corporation, conditioned that he should "faithfully discharge the duties of the office, and well and correctly behave therein." The Supreme Court of North Carolina held, in an action against him and his sureties on this bond, that the bond did not bind him to keep the money of the corporation safely against all hazards; that it only bound him to an honest, diligent and competently skillful effort to keep the money. The treasurer having deposited the money of the corporation to his credit as treasurer in a banking house, at the time in good standing and credit, and considered by the community a safe place of deposit for money, the treasurer and his sureties were held not to be liable for its loss by the sudden and unexpected failure of the banking house.[2] An action of contract by the corporation against a person to whom the treasurer of the corporation has, without authority, loaned to that person, thus misappropriating its funds, will not be held such a ratification of the treasurer's act as will relieve him from liability to the corporation.[3] It appeared also in this case that in the action brought against the borrower of its funds from its treasurer the corporation attached personal property of the borrower, a manufacturing corporation, of an uncertain value; that a mortgagee duly notified the officer that he claimed the attached property under a mortgage; that a receiver of the corporation appointed in New Jersey, where it was incorporated, offered to pay the plaintiff, in settlement of the suit, almost fifty per cent of its claim; that the plaintiff notified its treasurer and the sureties on the treasurer's bond of this offer, and offered to permit him, upon paying the amount due the plaintiff, to assume the control of the suit, and to assign to him its cause of action. The treasurer declined this proposition and the plaintiff made a compromise with the borrower of its funds through

[1] Bay View Homestead Assn. *v.* Williams, (1875) 50 Cal. 353.

[2] Atlantic & North Carolina R. R. Co. *v.* Cowles, (1873) 69 N. C. 59. That the rule does not apply to public officers or officers of public corporations, the same court has held in Comrs., etc., *v.* Clarke, 73 N. C. 255; Havens *v.* Lathene, 75 N. C. 505.

[3] Goodyear Dental Vulcanite Co. *v.* Caduc, (1887) 144 Mass. 85; s. c., 10 N. E. Rep. 483. The court said: "To hold that bringing a suit under such circumstances not only ratifies the loan, so far as the borrower is concerned, but condones the offense of the agent and relieves him from all liability, would be carrying the doctrine

the receiver, and gave a release reserving to itself its rights against the treasurer. The court held that this compromise, under the facts stated, did not release the treasurer from his liability to the corporation for misappropriation of its funds.[1]

§ 225. Rules as to liability of officers for diversion of property of corporation.— The New Jersey Court of Errors and Appeals has declared the following rules as to the liability of directors who have diverted the property of the corporation, and the principles upon which they are founded. Referring first to the change of legislation in that state repealing the "act to prevent frauds by incorporated companies," MAGIE, J., said: "But in my judgment the change in legislation has not deprived creditors of incorporated companies of all rights in respect to the property out of which their debts must be paid, if at all. As between creditors and stockholders, the corporate property has always been held to be a fund for the payment of debts, to which creditors have a right in preference to stockholders. 2 Story's Eq. Juris. § 1252. So the assets of a corporation cannot be divided among its stockholders, nor diverted to uses not contemplated by its charter, for the benefit of stockholders to the detriment of creditors. Nat. Trust Co. *v.* Miller, 6 Stew. Eq. 155; Guild *v.* Parker, 14 Vr. 430. Nor can directors, by fictitious credits, or by accepting overvalued property in payment for stock subscriptions, deprive creditors of the fund out of which their debts should be paid. Wetherbee *v.* Baker, 8 Stew. Eq. 501. These doctrines do not at all depend, as I conceive, on the existence of a corporation bankrupt law, or other like legislation, nor on the prohibitions of the statutes respecting transactions in fraud of creditors, but rather on principles inherent in the nature of corporations as to artificial persons whose creditors can only enforce their debts by a resort to the property the corporation has acquired. So, upon like principles, I apprehend that the property of an incorporated company is devoted to the payment

of implied ratification to an unreasonable and unjust extent."

[1] Goodyear Dental Vulcanite Co. *v.* Caduc, (1887) 144 Mass. 85; s. c., 10 N. E. Rep. 483. As to the personal liability of an agent representing a foreign corporation in Pennsylvania, where the corporation has not qualified itself to do business in that state upon contracts made on behalf of that corporation, see Lasher *v.* Stimson, (1892) 145 Pa. St. 30; s. c., 23 Atl. Rep. 552; 29 W. N. C. (Pa.) 404.

of the creditors thereof, at least to this extent, that it may not be diverted to other purposes. The corporation and its officers owe to their creditors this duty, not to divert the corporate property from the general purpose of paying the creditors. While they may dispose of the corporate property, and even prefer one creditor to another, they may neither give away the corporate property by a direct gift, nor by sale at less than its full and fair value, to the detriment of creditors. A violation of this duty will entitle the creditors who suffer thereby to relief. If the diversion of the corporate property from the payment of debts is effected by a mere gift, it is not necessary to discuss what relief could be afforded to creditors. If the diversion is effected under the guise of a sale, and the sale is not objectionable, as being made with intent to defraud creditors, then it is plain that relief cannot be afforded to creditors by setting aside the sale, for that, as we have seen, is not now prohibited. But, in such a case, it is equally plain that the directors who have effected such a diversion of corporate property from the payment of debts, have violated a duty, and will be personally liable to make up to creditors what has, by their acts, been thus diverted. When such diversion is charged to have been produced by a sale of corporate property to a stranger, the complaining creditors could obtain relief only by clear proof that by the fault of the directors, and in violation of their duty, the sale was made for less than the full and fair value of the property. But when directors make sale of corporate property to one of their number, who takes part in the transaction, as both buyer and seller, and creditors are thereby deprived of the opportunity to enforce their debts, then it results from the relation above mentioned as existing between them and the creditors; that it devolves on the directors to show that the transaction was made in good faith, and that the sale produced the full value of the property. If they fail to show these facts, creditors are entitled to compel them to account for the full value of the property. The fact that by reason of the sale it has been rendered difficult to determine the real value of the property sold, will not alter the measure of the directors' liability. If there is a conflict of evidence respecting value, the fact that by the act of one of the parties, the determination of the question has been rendered difficult or impossible, may be considered, but it cannot enlarge the liability of the directors, which is only for so much

as has been lost to the creditors by their misconduct.[1] In an action by a receiver of an insolvent Illinois corporation against its directors to recover misappropriated moneys of the corporation, the Supreme Court of that state has held that if the directors of an incorporated company apply the funds of the corporation to the discharge of their own indebtedness, or wrongfully pay an outgoing president a salary for past services not agreed to be paid until after their performance, they will be liable to the creditors of the company for the amount of the funds thus misapplied. It was also held that where a president of an incorporated company performs services as such, without any by-law or resolution providing compensation for his services, and afterwards accepts a salary voted to him for past services, he will be liable to refund the same in favor of creditors of the company.[2] The court further held, in this case, that the Statute of Limitations was no bar to a recovery, by the receiver of the insolvent corporation, from the directors, of the sums of money misappropriated by them.[3]

[1] Wilkinson *v.* Bauerle, (1886) 41 N. J. Eq. 635, 645, 646, in which the principles of the text were applied to the case before the court. See, also, on this subject, Dodd *v.* Wilkinson, (1886) 41 N. J. Eq. 566.

[2] Ellis *v.* Ward, (1890) 137 Ill. 509. The court said, upon this last point: "The doctrine is well settled in this court that the law will not imply a promise, on the part of a private corporation, to pay its officers for the performance of their usual duties. In order that such officers may legally demand and recover for such services, or the corporation legally make all awards and payment therefor, it must appear that a by-law or resolution has been adopted, authorizing and fixing such allowance before the services were rendered. American Central Ry. Co. *v.* Miles, 52 Ill. 174; Merrick *v.* Peru Coal. Co., 61 Ill. 472; Rockford, Rock Island & St. Louis Railroad Co. *v.* Sage, 65 Ill. 328; Cheeney *v.* La Fayette, Bloomington & Mississippi Ry. Co., 68 Ill. 570; 87 Ill. 446; Holder *v.* La Fayette, Bloomington & Mississippi Ry. Co., 71 Ill. 106; Gridley *v.* La Fayette, Bloomington & Mississippi Ry. Co., 71 Ill. 200; Illinois Linen Co. *v.* Hough, 91 Ill. 63. The rule is analogous to that governing trustees generally, who, at common law, were not entitled to compensation, except as there was warrant therefor in the contract or statute under which they acted."

[3] Ellis *v.* Ward, (1890) 137 Ill. 509. In this connection, it was said: "It is a principle of general application, and recognized by this court, that the assets of a corporation are, in equity, a trust fund (St. Louis & Sandoval Coal & Mining Co. *v.* Sandoval Coal & Mining Co., 116 Ill. 170), and that the directors of a corporation are trustees, and have no power or right to use or appropriate the funds of the corporation, their *cestui que trust*, to themselves, or to waste, destroy, give away, or misapply them. Holder *v.* La Fayette, Bloomington & Mississippi Ry. Co., 71 Ill. 106; Cheeney *v.* La Fayette, Bloomington & Mississippi Ry. Co., 68 Ill. 570; 1 Morawetz on Private Corpor. §§ 516, 517. And it is equally well settled that no lapse of time is a bar to a direct or express trust as between the trustee and *cestui que trust*. Chicago & Eastern Illinois Railroad Co. *v.* Hay, 119 Ill. 493; Wood on Limitation of Actions, § 200, and cases cited in note. If the trust assumed by the directors of a corporation in respect of the corporate property under their control, is to be regarded as a direct trust, as contradistinguished from simply an implied trust, then it is apparent, under the rule announced, the statute presents no bar to this proceeding by the receiver of the corporation. Ordinarily, an express trust is created by a deed or will, but there are many fiduciary relations established by law, and regulated by settled legal rules and principles, where all the elements of an express trust exist, and to which the same legal principles are applicable, and such appears to be the relation established by law between directors and the corporation. 2 Pomeroy's Eq. § 6; Id. §§ 1088–1090, 1094. And see, also, as respects stockholders, Hightower *v.* Thornton, 8 Ga. 486; Payne *v.* Bullard, 23 Miss. 88; Curry *v.* Woodward, 53 Ala. 371."

§ 226. Liability of officers arising from manner of execution of commercial paper.— In a case before the Appellate Court of Illinois the note sued on was subscribed by the defendants with the affix to one signature "Pres.," to the other "Sec.," and below the signatures "Salem Coal and Mining Co." They specially pleaded that the note was the note of the coal and mining company. It was held by the court that the fact that the note was signed by defendants as officers of a corporation, and the name of the corporation attached, did not release them from individual liability, in the absence of evidence that they were officers, and that the note was intended as the note of the corporation only.[1] In a case before the Minnesota Supreme Court, the note given to the plaintiff was signed by the defendant with the affix "Pres." to his signature. Its defense was that he was the president of a certain "club," a corporation organized under the laws of that state, and that he made the contract for articles for that club and gave this note for it. The Supreme Court held that where defendant undertook to overcome the plaintiff's *prima facie* case by testimony tending to show that the notes were executed by him in behalf and as the act of a corporation of which he was

[1] Williams *v.* Miami Powder Co., (1890) 36 Ill. App. 107. The court said: "The absence of all evidence on these questions renders it necessary to construe these notes according to the face of the notes, and in doing so the records 'Pres.' and 'Secy.' are to be regarded as *descriptionæ personæ* merely. They must be held according to their contract." Citing Hypes *v.* Griffin, Admr., etc., 89 Ill. 134; Stobie *v.* Dills, 62 Ill. 432; Bickford *v.* First Nat. Bank of Chicago, 42 Ill. 238; Trustees of Schools *v.* Rautenberg, 88 Ill. 219; Powers *v.* Briggs, 79 Ill. 493; Scanlan *v.* Keith, 102 Ill. 634.

president, and for its debt, and that this was well known and understood by the payee of the notes, to sustain the defense he should have gone further, and shown that not only the debt was one which the corporation had the power to incur, but that the corporation authorized it to be incurred.[1] Where in a negotiable

[2] Brunswick-Balke Collender Co. *v.* Boutell, (1890) 45 Minn. 21; s. c., 47 N. W. Rep. 261. The court said: "It is well settled in this court that when such a word as 'agent' or 'trustee,' which may be descriptive of the person, or may be descriptive of the character in which the signer contracts, is affixed to the name of the party entering into a contract, it is *prima facie* descriptive only, and that it may be shown by extrinsic evidence that the attached word was understood by all interested as determining the character in which the person using it contracted. Pratt *v.* Beaupre, 13 Minn. 187, 189; Bingham *v.* Stewart, 14 Minn. 153, 214; Deering *v.* Thom, 29 Minn. 120; s. c., 12 N. W. Rep. 350; Peterson *v.* Homan, 44 Minn. 166; s. c., 46 N. W. Rep. 303. In the earlier of these cases, where the words 'Agents Steamer Flora,' had been affixed to the defendants' signatures to a shipping contract, it was also settled that where a party seeks to change the *prima facie* character of the contract on the ground of agency, it is incumbent upon him to prove the fact of the agency. To establish that he acted in a representative capacity he must first show the existence of the capacity. If he assumes to act as an agent he must prove his authority to do so, or his liability upon the contract is necessarily of a personal character." In Frankland *v.* Johnson, (1893) 147 Ill. 520, an action was brought upon a note which was in these words: "On or before, etc., the Western Seamen's Friend Society agrees to pay or order the sum of * * * with interest, etc., [signed] [defendant's name] general superintendent," against the signer individually. The Supreme Court of Illinois said of this writing: "[It] is not distinctly the note of [defendant]. A personal note by him, in proper form, would have used the personal pronoun 'I' instead of the name of the corporation, and would have been signed without the description 'Gen. Supt.' Neither is it by its terms the note of a corporation. As such it should have been signed with the name of the corporation by its president, secretary or other officers authorized to execute it, or, as in Scanlan *v.* Keith, 102 Ill. 634, by the proper officers designating themselves officers of the corporation for which they assumed to act, or, as in Newmarket Savings Bank *v.* Gillet, 100 Ill. 254, using the corporate name both in the body of the note and in the signatures to it. But if it be conceded that, *prima facie*, a general superintendent of a corporation has authority to make promissory notes in its name, and this instrument be held to appear on its face to be the obligation of the society, rather than of [defendant], certainly it could not even then be contended that it was conclusively so. It is well understood that if the agent, either of a corporation or an individual, makes a contract which he has no authority to make, he binds himself personally according to the terms of the contract. Angell & Ames on Corp. § 303. It was said by SUTHERLAND, J., in Mott *v.* Hicks, 1 Cow. 513. s. c., 13 Am. Dec. 556: 'It is perfectly well settled that if a person undertake to contract, as agent, for an individual or corporation, and contracts in a manner which is not legally binding upon his principal, he is personally responsible (citing authorities). And the agent, when sued upon such a contract, can exonerate himself from personal liability only by showing his authority to bind those for whom he has undertaken to act. It is not for the plaintiff to show that he had not authority. The defendant must show affirmatively that he had.' This rule is quoted with approval in Wheeler *v.* Reed, 36 Ill. 91." They then considering it a question of fact which had been properly referred to the jury, and the latter, upon what the court deemed the strength of the testimony, having determined adversely to the defendant, held their conclusion not subject to review. As to such notes being *prima facie* the personal notes of the signers, see McNeil *v.* Shober & Carqueville Lithographing Co., (1893) 144 Ill. 238; Sturdivant *v.* Hull, 59 Me. 172; Tucker Manuf. Co. *v.* Fairbanks, 98 Mass. 101; Savage *v.* Rix, 9 N. H. 263; Bank *v.* Hooper, 5 Gray, 567; Trustees *v.* Rautenberg, 88 Ill. 219; Powers *v.* Briggs, 79 Ill. 493; Stobie *v.* Dills, 62 Ill. 433; Fiske *v.* Eldridge, 12 Gray, 474; Seaver *v.* Coburn, 10 Cush. 324. As to the admissibility of parol evidence in such cases to show whose note it was, see La Salle National Bank *v.* Tolu Rock & Rye Co., 14 Ill. App. 141; Mechanics' Bank *v.* Bank of Columbia, 5 Wheat. 326; Baldwin *v.* Bank of Newbury, 1 Wall. 234; Brockway *v.* Allen, 17 Wend. 40; Kean *v.* Davis, 21 N. J. L. 683; Haile *v.* Peirce, 32 Md. 327; Richmond R. Co. *v.* Snead, 19 Gratt. 354; Lazarus *v.* Shearer, 2 Ala. 718; Owings *v.* Grubbs' Admr., 6 J. J. Marsh. 31; McClellan *v.* Reynolds, 49 Mo. 312; Hardy *v.* Pilcher, 57 Miss. 118; Hager *v.* Rice, 4 Col. 90; Magill *v.* Hinsdale, 6 Conn. 464; Mann *v.* Chandler, 9 Mass. 335; Neill *v.* Spencer, 5 Ill. App. 473; Western Union *v.* Smith, 75 Ill. 496; Bowles *v.* Lambert, 54 Ill. 237; Stookey *v.* Hughes, 18 Ill. 55; Scanlan *v.* Keith, 102 Ill. 634.

promissory note, given for the debt of a corporation, the language of the promise does not disclose the corporate obligation, and the signatures to it are in the names of individuals who were in fact officers of the corporation, a *bona fide* holder, without notice of the circumstances of its making, is entitled to hold it as the personal undertaking of its signers, although they have affixed to their names the titles of their respective offices, as this will be regarded as descriptive of the persons and not of the character of the liability.[1]

[1] Casco National Bank of Portland *v.* Clark, (1893) 139 N. Y. 307; s. c., 34 N. E. Rep. 908. In this case the note sued on, given for the debt of the corporation, was written on a blank having printed on its margin the name of the corporation. No reference to the corporation was made in the body of the note, which read: "We promise to pay." It was signed by the president of the corporation in his individual name, with "Prest." written after, and in the same manner by its treasurer, with "Treas." added to his signature. The note was discounted by the bank for the payee before maturity. The New York Court of Appeals held that an action against the signers individually was maintainable; that the appearance in print upon the margin of the name of the corporation was not a fact carrying any presumption that the note was, or was intended to be, the note of the company; that it was competent for the officers to obligate themselves per-

§ 227. Liability of officers arising from indorsement of commercial paper.— A promissory note executed by a corporation, the name of which was subscribed to the note and those of the president and secretary attached, and the names of its directors indorsed upon the back of it, designating themselves as

sonally, and apparently they did so by the language of the note. The court said: "This must be regarded as the long and well-settled rule. Byles on Bills, §§ 36, 37, 71; Pentz *v.* Stanton, 10 Wend. 271; Taft *v.* Brewster, 9 Johns. 334; Hills *v.* Bannister, 8 Cow. 31; Moss *v.* Livingston, 4 N. Y. 208; De Witt *v.* Walton, 9 N. Y. 571; Bottomley *v.* Fisher, 1 Hurlst. & Colt. 211. It is founded on the general principle that in a contract every material thing must be definitely expressed, and not left to conjecture. Unless the language creates, or fairly implies, the undertaking of the corporation, if its purpose is equivocal, the obligation is that of its apparent makers. It was said in Briggs *v.* Partridge, 64 N. Y. 357, 363, that persons taking negotiable instruments are presumed to take them on the credit of the parties whose names appear upon them, and a person not a party cannot be charged upon proof that the ostensible party signed or indorsed as his agent. It may be perfectly true, if there is proof that the holder of negotiable paper was aware, when he received it, of the facts and circumstances connected with its making, and knew that it was intended and delivered as a corporate obligation only, that the persons signing it in this manner could not be held individually liable. Such knowledge might be imputable from the language of the paper, in connection with other circumstances, as in the case of Mott *v.* Hicks, 1 Cow. 513, where the note read, 'the president and directors promise to pay,' and was subscribed by the defendant as 'president.' The court held that that was sufficient to distinguish the case from Taft *v.* Brewster, *supra*, and made it evident that no personal engagement was entered into or intended. Much stress was placed in that case upon the proof that the plaintiff was intimately acquainted with the transaction out of which arose the giving of the corporate obligation. In the case of Bank of Genesee *v.* Patchin Bank, 19 N. Y. 312, referred to by the appellant's counsel, the action was against the defendant to hold it as the indorser of a bill of exchange, drawn to the order of 'S. B. Stokes, Cas.,' and indorsed in the same words. The plaintiff bank was advised, at the time of discounting the bill, by the president of the Patchin Bank, that Stokes was its cashier, and that he had been directed to send it in for discount, and Stokes forwarded it in an official way to the plaintiff. It was held that the Patchin Bank was liable, because the agency of the cashier in the matter was communicated to the knowledge of the plaintiff as well as apparent. Incidentally, it was said that the same strictness is not required in the execution of commercial paper as between banks; that is, in other respects, between individuals. In the absence of competent evidence showing or charging knowledge in the holder of negotiable paper as to the character of the obligation, the established rule must be regarded to be that it is the agreement of its ostensible maker and not of some other party, neither disclosed by the language nor in the manner of execution." To obviate the effect of this rule, the appellant in this case proved that one, a director of the corporation, the payee company, was also a director in the plaintiff bank at the time when the note was discounted, and it was argued that the knowledge chargeable to him as director of the former company was imputable to the plaintiff. To this argument the Court of Appeals said: "But that fact is insufficient to charge the plaintiff with knowledge of the character of the obligation. He in no sense represented or acted for the bank in the transaction, and whatever his knowledge respecting the note, it will not be imputable to the bank. National Bank *v.* Norton, 1 Hill, 572, 579; Mayor, etc., *v.* Tenth National Bank, 111 N. Y. 446, 457; Farmers', etc., Bank *v.* Payne, 25 Conn. 444. He was but one of the plaintiff's directors, who could only act as a board. National Bank *v.* Norton, *supra*. If he knew the fact that these were not individual, but corporate, notes, we cannot presume that he communicated that knowledge to the board. An officer's knowledge, derived as an individual, and not while acting officially for the bank, cannot operate to the prejudice of the latter. Bank of U. S. *v.* Davis, 2 Hill, 451. The knowledge with which the bank as his principal would be deemed chargeable so as to affect it would be where, as one of the board of directors and participating in the discount of the paper, he had acted affirmatively, or fraudulently, with respect to it, as in the case of Bank *v.* Davis, *supra*, by a fraudulent perversion of the bills from the object for which drawn; or as in Holden *v.* New York & Erie Bank, 72 N. Y. 286, where the president of the bank, who represented it in all the transactions, was engaged in a fraudulent scheme of conversion. It was said in the latter case that the knowledge of the president, as an individual or as an executor, was not imputable to the bank merely because he was the president, but because when it acted through him as president, in any transaction where that knowledge was material and applicable, it acted through an agent. The rule may be stated, generally, to be that where a director or an officer has knowledge of material facts respecting a proposed transaction, which his relations to it, as representing the bank, have given him, then, as it becomes his official duty to communicate that knowledge to the bank, he will be presumed to have done so, and his knowledge will then be imputed to the bank." See, also, Merchants' National Bank of Gardner *v.* Clark, (1893) 139 N. Y. 314 (an action upon similar notes to those in the case above, made by the same parties defendant). In Bremen Saving Bank *v.* Branch-Crookes Saw Company, (1891) 104 Mo. 425, the defendant corporation was sued on a note purporting to be signed by it as maker and one B. as indorser. It defended in its answer on the ground that it was a manufacturing and business corporation; that its name was used by B., the then president of the corporation, for his own accommodation, and for the purpose of satisfying his prior individual debt; that the note was so executed without any consideration moving to the defendant, and that the plaintiff, when it accepted the note, had knowledge of the foregoing facts. The court held that if the

"board of directors," was the cause of action in a Kansas case. The lower court refused any evidence as to the circumstances under which the names of the directors were indorsed upon the note, and they were held bound as guarantors of the note of the corporation. The Supreme Court held that as between the origi-

nal parties or any subsequent holder of this note accepting the same as collateral with full notice of all the facts and circumstances connected with the execution and delivery thereof, extrinsic evidence was admissible to show not only that the president and secretary executed the instrument in their official capacity as officers of the corporation, but also that the directors signed the note on the back thereof solely as officers of the corporation and to bind the corporation only.[1] In a Georgia case the promissory note on which the action was brought was signed by one as "ag't" payable to another, "pres't," and indorsed by the latter "president [name of corporation]." The action was brought by the indorsee, a bank, against the indorser individually and the corporation. In addition to the statutory form of such actions in that state, it was alleged that the maker was the agent and the indorser the president of the corporation, and that the money borrowed from the bank, and for which the note was given, was received and used by the corporation, and it undertook and promised to pay the bank. The effect of the statute of Georgia, that "where the agency is known, and this credit is

plaintiff was induced by defendant's conduct under the circumstances to believe in good faith that the defendant had assumed to pay the debt, though it did not in fact assume to pay it, defendant was liable. Citing Deere *v.* Marsden, 88 Mo. 512; Crawford *v.* Spencer, 92 Mo. 498; Fitzgerald *v.* Barker, 96 Mo. 661; Mechanics' Banking Assn. *v.* N. Y., etc., White Lead Co., 35 N. Y. 505; National Park Bank *v.* German-American Mut. W. & S. Co., 116 N. Y. 292; National Bank of Republic *v.* Young, (N. J.) 7 Atl. Rep. 488; Holmes, Booth & Haydens *v.* Willard, 24 N. Y. St. Repr. 260; Second National Bank *v.* Pottier & Stymus Mfg. Co., 18 N. Y. St. Repr. 954; Supervisors *v.* Schenck, 5 Wall. 784; La Fayette Savings Bank *v.* Stoneware Co., 2 Mo. App. 299.

[1] Kline *v.* Bank of Tescott, (1892) 50 Kans. 91. It was claimed in the case that the cashier of this bank, the assignee of the note, who was also a director of the corporation to the order of which the note was payable, assured these directors that the only way to make a corporation note was for the officers and directors of the corporation to sign their names and affix their official positions thereto, and that the note was thus signed under his direction to bind the corporation, but not the officers individually. The court said: "If the parties who wrote their names upon the back of the note as directors had signed their names upon the face thereof, they could have shown by extrinsic evidence that they were acting for the corporation only, and we perceive no reason why, as between the original parties or any subsequent holder of the note accepting the same as collateral, with full notice of all the facts and circumstances connected with the execution and delivery thereof, the same rule will not apply when such signatures are upon the back of the instrument before delivery."

not expressly given to the agent, he is not personally responsible upon the contract. The question to whom the credit is given is a question of fact to be decided by the jury under the circumstances of each case," was considered. The Supreme Court held that the suit against the payee individually was demurrable, the liability sought to be enforced being that of the corporation and not of its president individually; that the declaration showing on its face that the agency of the president was known, and that credit was extended to the principal, there being no allegation that credit was expressly extended to the agent; there was no issue which required submission to the jury. It was argued to the court that the statute had no application to the law-merchant and promissory notes the offspring of that law, and that the payee having been designated as "Pres't" merely when made the payee by the face of the note, was responsible individually, because he could not by the indorsement explain what that term "Pres't" meant; and when he turned over the note to the bank by his indorsement and gave them the control of the paper and title to sue it, he could not then limit his liability and indorse only as president. Of this contention the court said: "We cannot see the logic of any such conclusion, nor do we think that any such point has ever been adjudicated, even under the laws governing commercial paper unaffected by statute, as it is here, by the allegation that [the payee] and [maker] had power to contract for the corporation, and did so, and borrowed the money for the corporation that used it." It was also held that outside of the statute prior to indorsing the note payable to the order of the payee no liability arose against him; and when he indorsed it, the terms of such indorsement determined the contract between the indorser and indorsee, and the indorser could limit his liability by the terms thereof.[1]

§ 228. Liability of officers of savings banks.— In a case where the trustees of a savings bank, the business of which had been a losing one from the start, its deposits not large and its expenses exceeding its income, doing business in hired rooms, purchased real estate for a large sum out of the funds in its care

[1] Bank of the University *v.* Hamilton, (1886) 78 Ga. 312. Cases as to indorsement of paper by officers: Middlesex County Bank *v.* Hirsch Bros. Veneer Mfg. Co., 4 N. Y. Supp. 385; Sheridan Electric Light Co. *v.* Chatham National Bank, 52 Hun, 575; s. c., 5 N. Y. Supp. 529.

and agreed to erect a building thereon at a further large cost, before the completion of the same the bank became hopelessly insolvent and passed into the hands of a receiver. The receiver brought his action against the trustees for damages on account of an improper investment of its funds on their part in the matter above stated. The New York Court of Appeals, considering the relation between these trustees and the bank to be that of agents and principals, and between them and the depositors as similar to that of trustee and *cestui que trust*, held, that in transcending the limits placed upon their power in the charter of the bank and causing damage to the bank or its depositors, they would be personally liable for the damages. They affirmed the judgment against the trustees in the lower courts and dismissed the appeal.[1] As agents of the bank such trustees are

[1] Hun, Receiver, *v.* Cary, (1880) 82 N. Y. 65, affirming 59 How. Pr. 426. The contention in this case on the part of the defense involved the extent of the care to be exercised by such trustees of the funds and the uses to which they devoted them. EARL, J., speaking for the court, after referring to the following cases: Scott *v.* De Peyster, 1 Edw. Ch. 513; Spering's Appeal, 71 Pa. St. 11; Hodges *v.* New England Screw Co., 1 R. I. 312; s. c. in 3 R. I. 1; The Liquidators of Western Bank *v.* Baird, 11 Sess. Cas. (3d series) 112 (Scotch); The Charitable Corporation *v* Sutton, 2 Atk. 405, and Litchfield *v.* White, 3 Sandf. 545, said: "In Spering's Appeal Judge SHARSWOOD said that directors 'are not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they were honest, and provided they are fairly within the scope of the powers and discretion confided to the managing body.' As I understand this language I cannot assent to it as properly defining to any extent the nature of a director's responsibility. Like a mandatory, to whom he has been likened, he is bound not only to exercise proper care and diligence, but ordinary skill and judgment. As he is bound to exercise ordinary skill and judgment, he cannot set up that he did not possess them. When damage is caused by his want of judgment he cannot excuse himself by alleging his gross ignorance. One who voluntarily takes the position of director, and invites confidence in that relation, undertakes, like a mandatory, with those whom he represents or for whom he acts, that he possesses at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties. Story on Bailments, § 182. Such is the rule applicable to public officers, professional men and to mechanics, and such is the rule which must be applicable to every person who undertakes to act for another in a situation or employment requiring skill and knowledge, and it matters not that the service is to be rendered gratuitously. These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings, and to intrust the safe keeping and management of them to their skill and prudence. They undertook not only that they would discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust."

[1] Hun *v.* Cary, (1880) 82 N. Y. 65. That they may be treated as agents of the bank, see In re German Mining Co., 27 Eng. Law & Eq. 158; Belknap *v.* Davis, 19 Me. 455; Bedford R. R. Co. *v.* Bowser, 48 Pa. St. 29; Butts *v.* Wood, 38 Barb. 181; Austin *v.* Daniels, 4 Denio, 299; O. & N. R. R. Co. *v.* McPherson, 35 Mo. 13. As to the liability of trustees to restore the money illegally invested by them, see Adair *v.* Brimmer, 74 N. Y. 553; London *v.* Birmingham R. R. Co., 5 De Gex & Smales, 414.

[2] Williams, Receiver, *v.* Riley, (1881) 34 N. J. Eq. 398. It was said by the chancellor: "The defendant willfully disregarded the regulations made by the board of managers for the security of the depositors, by which it was, in effect, provided that no investment should be made unless approved by the finance committee, and that all applications for investment of the funds should be made to them alone. With full knowledge that the investment not only had not been duly authorized, but was one forbidden by the charter, he, with the concurrence of the president, indeed, but, nevertheless, in violation of his duty and trust, as it was in violation of the duty and trust of the president, took from the funds of the bank, by check drawn by himself as treasurer, the amount of the bond and mortgage on the assignment of these instruments to the bank. Nor can he shelter himself under the suggestion that though he was a manager and officer, he is to be regarded as standing in the relation of a stranger to the bank in this transaction. He was a trustee, and, as such, bound to protect the interests of his *cestuis que trust*. That obligation involved a strict adherence to the provisions of the charter and the regulations of the bank designed for their protection. He would not have been at liberty to disregard them if the application had come from a stranger. On what principle can he be justified in disregarding them in his own dealings with the bank? Had a stranger sought to obtain from the bank the money for the bond and mortgage, it would have been the duty of the defendant, if the matter came to his knowledge in time, to object to it, and if his objection had been unheeded it would have then been incumbent on him to do what he could to prevent the illegal transaction. Crane *v.* Hearn, 11 C. E. Green (N. J.),

responsible to it for misfeasance or nonfeasance causing damage to the bank, upon the same principle that any agent is for like cause responsible to his principal.[1] The Chancery Court of New Jersey has held the treasurer of a savings bank, at the same time one of its managers, who had assigned to the bank a bond and mortgage owned by him on land not worth double the mortgage as required by the bank's charter, and without submitting the investment to the finance committee for approval, as required by its by-laws, personally liable for the loss sustained on the bond and mortgage. Further, that the fact that the manager did not object or repudiate the transaction for six years was no defense whether his breach of duty was known or not known by the other managers.[2]

§ 229. Liability of a treasurer of a corporation for payment of orders on forged indorsements.— Certain orders upon the treasurer of a building association, a Pennsylvania corporation, signed by the president and attested by the secretary, to certain payees, were paid by the treasurer to the secretary, the latter having forged indorsements of the payee upon the same. The association brought its action upon the bond of the treasurer to hold him liable for these improper payments, as they contended. The Supreme Court of the state held that the treasurer should have had judgment in his favor.[1]

378. Manifestly he is without excuse now. He has been guilty of a misapplication, at least, of the funds of the bank, and where there has been a waste or misapplication of the funds of a corporation by an officer or agent of the corporation suit may be brought in equity, in the name of the company, to compel him to account for such waste or misapplication or breach of trust. Citizens' Loan Association *v.* Lyon, 29 N. J. Eq. 110; s. c., affd. on appeal, 30 N. J. Eq. 732. Here the misapplication was by one who was not only an officer of the institution but a trustee also. Stockton *v.* Mechanics & Labor. Sav. Bank, 32 N. J. Eq. 163; Hannon *v.* Williams, 34 N. J. Eq. 255. And he is bound to indemnify his *cestuis que trust*, and the receiver may maintain suit against him to obtain the indemnity."

[1] Hibernia Building Assn. *v.* McGrath, (1893) 154 Pa. St. 296. The opinion rendered by THOMPSON, Justice, fully presented the facts and the by-laws regulating the conduct and acts of officers, and fully discussed the law applicable to such a case, as follows: "The ground of liability was negligence in making these payments, although made upon orders signed by the president and secretary, who also attested the signatures of the payees. The money was either paid in cash to the secretary, or by cheques payable to his order. Under the by-laws the president was required to sign all orders drawn upon the treasurer for appropriations made by the board, the secretary to keep accurate minutes, to attest all orders drawn on treasurer for appropriations made by the board, the treasurer to pay all orders drawn on him by order of the board, if signed by the president and attested by the secretary. The orders upon which these payments were made were in the usual form, and signed by the president and attested by the secretary. The [treasurer] having no reason to suspect or doubt the integrity of either the president or the secretary, and acting in good faith, paid them. As the [treasurer] served without compensation for his services he became a gratuitous bailee, and as such is to be held liable for gross negligence only. In Tompkins *v.* Saltmarsh, 14 Serg. & R. 275, it was said: 'Tompkins is charged, as the bailee of Saltmarsh, on an undertaking to perform a gratuitous act, from which he was to receive no benefit, and the benefit was solely to accrue to the bailor, in which case the bailee is only liable for gross negligence, *dolo proximus*, a practice equal to a fraud.' This rule thus stated is repeated in Scott *v.* Bank of Chester Valley, 72 Pa. St. 471; Bank of Carlisle *v.* Graham, 79 Pa. St. 117. His designation as treasurer did not change the character of the bailment. As provided in the by-laws the money was deposited with him to be paid out when required upon orders drawn in the manner as stated. A treasurer or a director may become a gratuitous bailee, and his official position and designation will not in any degree change his liability as such bailee. In Swentzel *v.* Bank, 147 Pa. St. 153, it was held that directors who are gratuitous mandatories were only liable for fraud or such gross neglect that amounts to fraud. In this case the [treasurer] had no office or place in which, as treasurer, he transacted the business of the association. When orders were to be paid he testifies he would get notice from the secretary to come down and see him; that he had some that he wanted paid, and that he would go to the secretary's store and would there pay them to him. The [association's] business was managed principally by its secretary, who came in contact directly with its members. In view of the by-law and the modes of payment, it is very clear that he was a gratuitous bailee, and is to be held only to that diligence required as such. It is true he gave a bond as required by the by-law for the faithful performance of his duties, but that did not change the duty cast upon him by law as a bailee. The condition of the bond was that he should perform and discharge the duties of the office, and shall keep a just and true account of the moneys received, and shall pay to his successor the moneys received, and shall account for the moneys so received. The condition of the bond, therefore, was that he should faithfully perform the duties in regard to the bailment that the law required him to perform. It is, however, contended that as the bond provides that he shall discharge all the duties now required or may hereafter be required of him as treasurer by the constitution, charter, by-laws, rules and regulations of said association, and as the board passed a resolution that all applications for withdrawals of stock must be approved by the board of directors at regular or special meetings of the association before payments are made, the [treasurer] was guilty of negligence, without examining the minutes and without satisfying himself that the board had acted upon the withdrawals for which the orders in question purported to have been drawn. It is established by the proofs that no entries were made upon the minutes for [of?] application of [for?] withdrawals after 1884. In point of fact the secretary, after this date, kept no record in the minutes of any withdrawals. The duty of the president is to preside at all meetings of the board and to sign all orders for appropriations authorized by the board; that of the secretary is to keep accurate minutes of all meetings of the board, the accounts of the association, and to attest all orders on the treasurer for appropriations of the board. These orders in question were signed by the president and were attested by the secretary in the usual form. The president was and is still regarded as an upright man; the secretary was also at this time so regarded; the asso-

§ 230. Liability on a contract made before complete organization of the corporation.— In an Ohio case it appeared that individuals who had undertaken to have an association known as the "Wool Growers' Exchange" incorporated under the laws of Ohio obtained a certificate of incorporation, and before the requirement of the law as to the subscription to the stock of a certain percentage of the capital stock before doing business had

been complied with, had a meeting of stockholders and were elected directors and officers of the association. They then entered into a contract for the purchase of wool, and for an unpaid balance gave a note through the officers of the association. The holder of the note brought action upon the note as the foundation of the suit against these directors as personally liable on the contract under the facts disclosed in the case. The Supreme Court of Ohio held them liable personally on the contract.[1] The

ciation trusted both of them implicitly, and had no reason or cause to doubt them. If it treated them thus, it was natural that the [treasurer] should in no manner suspect or doubt them. These orders, therefore, came to him with the certificate of the presiding officer, whose duty it was to preside at all meetings, and with the attestation of the secretary, whose duty it was to keep all records of the meetings. If the [treasurer] had gone to the secretary he would doubtless have been assured that the board had acted upon these withdrawals, and having been so advised he would have been justified in paying them. It can be scarcely said to be want of ordinary diligence to have paid these orders under these circumstances and with these signatures. They were, in fact, as express an authorization as if he had seen these officers officially. It was said in Swenzel *v.* Penn. Bank, *supra:* 'Nor do we think the directors were bound to regard the statements submitted to them as false, and the president, cashier and clerks as thieves. They had nothing to arouse suspicion. All of these gentlemen stood high. They were the trusted agents of the corporation.' The [treasurer] was not guilty of negligence in trusting the secretary and in putting full faith in his action, and that of the president in signing and sending to him the orders in question."

court discussed quite at length the liability of agents under such circumstances, and then said: "While, however, the authorities generally agree that a person who, without having in fact authority to make a contract as agent, yet does so under the *bona fide* belief that such authority is vested in him, is nevertheless personally responsible to those who contract with him in ignorance of his want of authority, a diversity of opinion is found in the cases in regard to the exact nature of the liability, and the character of the action by which it may be enforced. In Jenkins *v.* Hutchinson, 13 Ad. & E. 746, it is intimated by ERLE, J., that an action of decit would lie in such cases, notwithstanding the good faith of the agent, and some authorities may be found to that effect. Another class of cases hold that the liability is upon the contract; but, it is believed, that whether the agent is so liable, depends upon the intention of the parties as discovered from the contract itself; and on this question the form of the agreement and the mode of signature may be quite conclusive. The rule on this subject, as stated in Story on Agency, is that an agent cannot be sued on the very instrument itself, as a contracting party, unless there be apt words to charge him. Section 264*a*. Still another class of cases establish the rule, which we are inclined to adopt, that in cases like the one we are considering, the agent is liable upon his implied promise that he pos-

[1] Trust Co. *v.* Floyd, (1890) 47 Ohio St. 525; s. c., 26 N. E. Rep. 110. The

Supreme Court of Kansas affirmed a judgment against alleged directors of an athletic association upon a contract for goods furnished, holding them individually liable on the ground that the corporation had not been fully organized under the law. They said upon the subject generally: "The rule is well established

sesses the authority he assumes to have. Smith's Leading Cases, vol. 2, pt. 1, 408 (8th ed.), and cases there cited; Lewis *v.* Nicholson, 83 Eng. C. L. 512. In White *v.* Madison, 26 N. Y. 117, in a learned opinion, it is held that the liability of the agent in such cases rests upon the ground that he warrants his authority, and not that the contract is to be deemed his own. Bartholomew *v.* Bentley, 15 Ohio, 659, is referred to as establishing both that the liability of the agent in cases of this kind is founded on fraud, and that the petition should charge a fraudulent intent in direct terms. That was an action in case for deceit under the practice which prevailed before the adoption of the Code of Civil Procedure. The questions arising upon the demurrer related to the form of the remedy, and the sufficiency of the declaration in such an action. They are stated by BIRCHARD, J., to be: '*First.* Can a special action on the case for fraud, which has resulted in damage of the plaintiffs, be maintained in a case like this upon sufficient declaration? *Second.* Is this declaration good upon demurrer?' The court answers the first question in the affirmative, and, in speaking of the declaration, says: 'The objection taken by counsel is a want of certainty. The action is founded on a fraudulent combination, and for holding out false colors at the commencement of the banking operations, and at various subsequent periods. The only direct charge of a fraudulent intention is in the withdrawal of the funds, and this, for aught that appears, may have been long since the bills in plaintiff's hands were issued. * * * It is thought that the averment of a fraudulent design should have been made in positive terms as to each specific act relied upon to sustain the action.' Under the practice then in force, pleadings were subject to demurrer, unless they were appropriate in their form and allegations to the particular action pursued; and we do not understand it to be there decided that no other action could be maintained on the facts of that case. A different action was maintained in Medill *v.* Collier, 16 Ohio St. 599, which, so far as the ground upon the liability of the bank directors was placed, is not greatly dissimilar to the case before us. Under our present system of pleading, it is not important what was formerly the most appropriate remedy. Upon the facts stated in the petition, the law, we think, implied a promise on the part of the defendants, that in making the contract with the plaintiff, they had authority to bind the corporation they assumed to represent; and if they had not, they are answerable for the consequences. That they were without such authority seems clear. Upon the lack of authority upon the part of the directors, it was then said: 'It was held by this court in Bartholomew *v.* Bentley, 1 Ohio St. 37, that while mere irregularities in organizing a corporation would not subject the officers to private liability, to protect them from such liability, the provisions of the act of incorporation must be substantially pursued. By our statutes, under which the proceedings

that a corporation must have a full and complete organization and existence as an entity, and in accordance with the law to which it owes its origin, before it can assume its franchise or enter into any kind of a contract or transact any business; and whatever be the mode prescribed by the act of incorporation, a substantial compliance with all the provisions of the law under which it is created is required before the corporation can be said to have such an existence as will entitle it to do business.[1] And it is conceded in this case that nothing was done to perfect the organization after the charter was filed. A corporation cannot act without officers and agents, and it is powerless to do anything until its incorporators or promoters give it the means whereby it can act. The words "organize" or "organization" have a well-understood meaning; and as we construe them they mean the election of officers, providing for the subscription and payment of the capital stock, the adoption of by-laws and such other steps as are necessary to endow the legal entity with the capacity to

were taken for the formation of the corporation referred to in the petition, the corporate powers, business and property of corporations formed for profit must be exercised, conducted and controlled by a board of directors, all of whom must be stockholders; the articles of association must state the amount of the capital stock, and the number of shares into which it is divided; and at least ten per cent of that amount must be subscribed before directors can be chosen. So that the subscription of the necessary amount of the capital stock to authorize the election of directors is not only a matter of substance, but is essential to the organization of the corporation, and necessary to the transaction of business by it. It is the security which the law requires shall be provided before the corporation enters upon its business for the protection of those who may deal with it. The statutory liability of the stock subscribers is an additional security. In the effort to form the corporation in question, neither of these securities was provided. Counsel contend that it is, nevertheless, a corporation *de facto*, and estopped to deny its liability to the plaintiff. If it were, it is not readily perceived how this would aid the defendants. Until there were stock subscriptions to an amount warranting the organization, the subscribers could not be compelled to pay beyond the sum required at the time of the subscription; nor would the statutory liability attach, unless there were some ground of estoppel, not appearing in the case. The implied undertaking of the defendants was that they represented a corporation with the capital stock required by law; while the one to which they insist the plaintiff shall be compelled to resort was, if a *de facto* corporation, so only in name, without substance or capacity; and if the doctrine of estoppel could be brought to the aid of the plaintiff against it, the defendants are not in a position to require a resort to that remedy to relieve them from the liability they have incurred.'"

[1] Citing 4 Am. & Eng. Encycl. of Law, 197, and authorities cited there.

transact the legitimate business for which it was created. In this sense the corporation was not fully organized. While it had an existence, the organization was never completed so that the corporation could do business. In the case of Hart *v.* Salisbury, 55 Mo. 310, which was an action brought upon a note purporting to have been executed by the directors of an agricultural association, the suit was brought against the directors upon the ground that the association was not incorporated at the time the note was given, and that the directors were, therefore, individually liable. It appeared that the association was not fully incorporated when the note was executed. The law required the charter to be filed with the recorder of the county where the corporation was located, and also in the office of the secretary of state. The charter was only filed with the recorder. The court held that the officers of the corporation had no power to issue the note, and that a note issued and signed by them would bind them personally and not the corporation. The court said, in speaking of the attempted organization of that corporation: It had organized under section 2, chapter 69, General Statutes of 1885, page 367, by signing and acknowledging and recording in the recorder's office of the proper county the articles of the association. This step being taken, it was an organized corporation, not for the transaction of business, but for the purpose of taking the next and last step to complete its authority to transact business and give date to its legal existence. Until the officers took this final and necessary step by depositing and filing in the office of the secretary of state a copy of the articles of association as they stood recorded in the county, this corporation had no power to issue the note sued on. As it had no power to issue this note, the defendants are undoubtedly liable." "If a corporation be illegally formed, its members or stockholders are liable as partners for its acts or contracts; and directors, officers or agents acting and contracting in its name render themselves personally liable." Beach Priv. Corp. § 16; Marshall *v.* Harris, 55 Iowa, 182; Kaiser *v.* Savings Bank, 56 Iowa, 104; Coleman *v.* Coleman, 78 Ind. 344. The Kansas court resumed: "While in this case the charter was filed with the secretary of state, the corporation had no officer outside of the directors named for the first year. No portion of the capital stock had been subscribed and no books opened, as required by section 1173 of the General Statutes of 1889. In

fact nothing had been done to complete the preliminary business of organizing the corporation. We do not understand that a corporation can proceed to the transaction of business without any portion of its capital stock being subscribed or paid. It may have been the English rule, but in the United States it is otherwise. Boone Corp. § 113. The corporation has no means or capacity to act until some portion of the capital stock named in the charter has been subscribed and paid. Some states have by a legislative rule made directors of certain corporations jointly and severally liable for all debts of the corporation until the whole amount of the capital stock has been paid in. Rev. Stat. of Wis. 1878, § 1901."[1]

§ 231. Rule as to recovery in such a case.— The measure of damages in such a case was one of the questions in this Ohio case. Referring to the theory upon which, as it appeared, the case was tried, that if the defendants were liable at all, the amount which the plaintiff was entitled to recover was the balance due on the contract, the Supreme Court of Ohio said: "This was not necessarily the measure of recovery. As we have already seen, the action in such cases is not founded on the contract made for the supposed principal, but as the implied promise of the agent that he had authority to bind the principal; and the damages which may be recovered for its breach is the loss sustained by the plaintiff by reason of his not having the valid contract which the agent undertook that he should have. The damages may sometimes exceed the amount due on the contract made in the name of the principal, for it is held they may include the costs and expenses of an unsuccessful action against the principal to enforce the contract. White *v.* Madison, 26 N. Y. 117; Simons *v.* Patchett, 7 E. & B. 568; Collen *v.* Wright, 7 E. & B. 301; 2 Smith's Leading Cases, 410. In Morawetz on Corporations it is said that the measure of damages in an action against directors or officers of a corporation, who induce a person to deal with it before the capital indicated in its charter has in fact been provided, is the loss sustained 'by reason of the difference between the capital which he has received and that which he was entitled to expect.' Under this rule, we think, the plaintiff might properly recover the balance remaining unpaid and the purchase price of

[1] Walton *v.* Oliver, (1892) 49 Kans. 107, 112, 113, 114; s. c., 30 Pac. Rep. 172.

the wool sold. *Prima facie*, that is the amount of the plaintiff's loss, and it does not exceed the amount of the capital which the corporation was required by law to have before it could be represented by the directors, and which the defendants, by assuming to act for it, undertook that it did have. It is true the petition alleges that the corporation is insolvent with an indebtedness exceeding ten per cent of the capital stock; but whether the claims of other creditors stand upon a like footing with that of the plaintiff, or will be enforced against the defendants, does not appear. Besides, if the proper stock subscriptions had been obtained, the corporation might not have become insolvent, or, before it did, the plaintiff's claim might have been paid or secured. If, in such case, the plaintiff could recover no more than a sum equal to the proportion of the capital which should have been provided that his claim bears to the whole indebtedness contracted in the corporate name, it would be necessary to take an account of the assets and liabilities to determine the amount of the recovery. That rule, applied to this case, would require that the defendants be charged with an amount equal to the necessary stock subscriptions, and the statutory liability of the subscribers, and that all the creditors be brought in to have their claims adjusted, before the amount of the verdict could be arrived at."[1]

§ 232. County treasurer liable upon his receipts to collector for money.— A county auditor in California made a settlement with a collector of license taxes of the county, determined the amount due the county from this collector and certified the same to the county treasurer. The county treasurer gave a receipt for the amount to the collector, and the collector, upon presenting it to the county auditor, received his discharge, and the auditor charged the same to the treasurer. The latter, also, debited himself to that amount in his account with the county. When he went out of office there was a deficiency of a certain amount, and an action was brought upon his bond by the county to recover the deficiency. The defense made by the treasurer and his sureties was that, in reality, the sum of money due from the collector was not paid in full to him, and that the collector was the one indebted to the county. The Supreme Court of

[1] Trust Company *v.* Floyd, (1890) 47 Ohio St. 525, 542, 543; s. c., 26 N. E. Rep. 110.

California held that, assuming the facts to be as contended by the treasurer and his sureties, they did not constitute a defense to the action.[1]

§ 233. County treasurer liable as bailee of county funds.— In a Colorado case the governing authorities of a county sought, claiming a shortage in the accounts of a county treasurer, deceased, to follow the funds as trust funds in his estate as held by his representatives and to have a preference over other creditors of the estate. The Supreme Court in its opinion first considered the question of the relationship held by a county treasurer to the funds coming into his hands by virtue of his office,

[1] San Luis Obispo County *v.* Pettit, (Cal. 1893) 34 Pac. Rep. 1082. The court said: "Section 115 of the County Government Act (St. 1891, p. 323) requires the county auditor to settle the accounts of all persons holding moneys payable into the county treasury, and to certify the amount to the treasurer; and provides that, upon the presentation and filing of the treasurer's receipt therefor, he shall give to such persons a discharge, and charge the treasurer with the amount received by him. In Butte Co. *v.* Morgan, 76 Cal. 1; s. c., 18 Pac. Rep. 115, it was held that the auditor is not required to go to the treasurer and ask him whether the amount has been actually paid, or, in other words, whether the receipt states the truth. He is authorized to accept the receipt as sufficient evidence of the fact of payment. This case presents many points similar to the present one, and must be regarded as controlling. Section 80 of the County Government Act requires the treasurer to settle his accounts with the auditor on the first Monday of each month, and, for the purpose of making such settlement, to make a statement under oath of the amount of money received prior to the period of such settlement, the sources whence the same was derived, and the amount remaining on hand. These settlements and statements were made by [this treasurer], and he ought not now to be permitted to exonerate himself from liability to the county by showing that these statements were false, and that, instead of requiring [the collector] to pay the money into the treasury, he had taken his individual promise to pay it at a subsequent date. By delivering to the auditor his receipt for the moneys which [the collector] had collected, he had authorized the auditor to enter upon his books a discharge of [the collector's] liability, and is thereby estopped from questioning the correctness of his receipt. If he chose to permit [the collector] to retain this money upon his promise to subsequently pay it to him, to that extent he failed to perform his official duty in requiring the money to be paid into the treasury, and must be regarded as having become himself, rather than the county, the creditor of [the collector]. If any loss occurred by reason of [the collector's] subsequent failure to pay his check, it should be borne by [the treasurer], rather than by the county, since the loss had been made possible by reason of [the collector's] violation of his official duty, and his sureties are liable to the county equally with him for such misappropriation or loss of the money."

the contention by the county authorities being that the relation was that of bailee of the funds, and that of the representatives of the estate that the relation of debtor and creditor existed between him and the county. The court said: "Without determining where the weight of authority lies on this question, as there is much conflict between the adjudged cases, we think that, under the provisions of the statute relating to a county treasurer, the money collected and received by him belongs to the county, and that he holds a fiduciary relationship thereto that constitutes him a bailee, with express and extraordinary liability. The bond he is required to give before entering upon the duties of his office is conditioned that he 'shall faithfully and promptly perform the duties of said office * * * pay, according to law, all moneys which shall come to his hands as treasurer, and shall render a just and true account thereof, whenever required by said board of commissioners or by any provision of law, and shall deliver over to his successor in office, or to any other person authorized by law to receive the same, all moneys, books, papers, and other things appertaining thereto or belonging to his office.' Mills' Ann. St. § 886. Section 890 of Mills' Annotated Statutes provides: 'It shall be the duty of the county treasurer to receive all moneys belonging to the county from whatever source they may be derived. * * * All moneys received by him for the use of the county shall be paid out by him only on the orders of the board of commissioners, according to law, except where special provision for the payment thereof is or shall be otherwise made by law.' It is further provided in section 901 of Mills' Annotated Statutes: 'Upon the resignation or removal from office of any county treasurer all the books and papers belonging to his office shall be delivered to his successor in office, upon the oath of such preceding treasurer, or, in case of his death, upon oath of his executors or administrators, etc.' The Supreme Court of Indiana having announced the doctrine in several cases that a township trustee, in common with a county treasurer, was not a mere bailee, but the owner of the money that came into his hands by virtue of his office, that court distinguished and limited such ownership in Rowley *v.* Fair, 104 Ind. 189; s. c., 3 N. E. Rep. 860, as follows: 'But the title of a township trustee in the money for which he is held accountable is only recognized to the extent that is necessary for the better preservation of the various

funds which the money represents, and is, in fact, a legal title only in a technical and very limited sense. The equitable title to, and the beneficiary interest in, such money is in the township, and in that view the money for which the trustee is liable upon his bond really belongs to the township.' It follows that, if the money received by the treasurer by virtue of his office belongs to the county, it constitutes a trust fund, which, if diverted and misappropriated, may be recovered in an action upon his bond, or the county may, if it elect, treat it as a trust fund, and follow it wherever it can be traced."[1]

§ 234. County treasurer paying court orders on forged indorsements.— It appeared in a Minnesota case that a deputy clerk of the District Court issued false and fraudulent certificates, in which he certified that certain named persons had served as jurors in said court, and were each entitled to a stated sum of money payable to their order as compensation. He obtained the written order of the county auditor on each, directing the county treasurer to pay the same. He forged the names of the respective payees on the back of each certificate, presented the same to the treasurer, and the latter paid over to him the amounts called for out of the county funds, without attempting to satisfy himself of the genuineness of the indorsements upon the backs of the instruments. The Supreme Court held that the treasurer was liable to the county for the sums so paid out.[2]

[1] McClure *v.* Board of Comrs. of La Plata County, (Colo. 1893) 34 Pac. Rep. 763; citing Sauer *v.* Town of Nevadaville, 14 Colo. 54; s. c., 23 Pac. Rep. 87.

[2] Board of County Commissioners of Ramsey Co. *v.* Nelson, (1892) 51 Minn. 79. *Arguendo*, the court said: "The distinction between a case arising on these facts and * * * Sweet *v.* County Commissioners of Carver County, 16 Minn. 106, is obvious. There the county orders or warrants had been issued and accepted, made payable to a certain named person or to bearer. They were transferable by simple delivery, and, in terms, the treasurer was expressly authorized to pay to the bearer. This he did without knowledge of any defect in the title of the bearer, and it was held, such payment being in good faith every way, that the county was exonerated from further liability. The conclusion of the court was expressly placed upon the fact that in good faith the county treasurer had paid these obligations precisely as he was authorized and directed to do, to the person who presented them, the bearer thereof. But the cases are not analogous, for, giving to defendant the benefit of all that is possible, namely, that together the certificates as issued and the indorsements thereon as made by the county auditor amounted to orders or warrants upon the county treasury, the prominent and stubborn fact remains that the amounts said to be due thereon were not to be paid to a bearer of the instruments, but to the order of the several persons named therein as payees. As in the case just referred to, the authority to pay was express and distinct, but instead of directing that such payment should be to whomsoever might present the orders or warrants, the direction was that payment should be made to the order of a person designated by name. And at this time it may be well to state that it does not appear in the complaint, as appellant's counsel seem to assume, that fictitious or nonexistent persons were named as payees in these certificates. It is of no importance, probably, but from the language of the pleading the presumption is otherwise. Payments were not made to the persons named as payees, or to their order, in accordance with the terms of the certificates, but were made to * * * the very person who as deputy clerk had the opportunity and had fraudulently issued the same, solely upon the false and forged indorsements of the names of the payees. Common prudence ought to have suggested to [the treasurer] that before making such payments it was incumbent upon him to ascertain and satisfy himself of the genuineness of the signatures which he found indorsed upon the backs of the instruments purporting to be those of the payees therein named. He failed so to do, and this of itself is sufficient to sustain the charge of negligence in the performance of his official duty. As was said by the learned trial judge, had defendant observed the rule of law which governs in commercial transactions of the same nature, he would have detected the forgeries at the outset, and there could have been no great loss to the county or to himself. His disregard of this rule was negligence, undoubtedly, and it was the immediate and proximate cause of the loss to the county, for which defendant must be held responsible, unless the fact that the certificates were fraudulently issued by the deputy of another county officer for whose malfeasance such officer was also responsible to the county can be allowed to excuse and relieve him. The instruments in question were certificates of indebtedness for jurors' services falsely stated to have been rendered by the payees therein named, and on whose order payment was to be made. At most, they were the orders of one officer of a municipal corporation upon another officer for the paying out of municipal funds. Although negotiable in form, they were not commercial paper in any

§ 235. Arbitration as to liability of a treasurer of a township.— The treasurer of a township having used the moneys of the public corporation there was a submission of the question of the extent of his liability upon his bond to arbitration, and a settlement made upon the basis of the award, the bondsmen released and in part settlement of the matter notes given to the township. In an action upon one of these notes the treasurer intervened, and the insistment on his behalf was that the arbitration could not be sustained because the corporation's powers were only such as were given by statute, and no express power was given to submit to arbitration. To this the Supreme Court of

Iowa said: "A corporation has, however, not only such powers as are expressly conferred, but such others as are reasonably incident to the exercise of those expressly conferred. The intervenor's theory is that the plaintiff [the corporation] should be confined to its remedy by action. But the power which it is conceded that the plaintiff has to maintain an action does not appear to be expressly conferred. The plaintiff has express power to make settlement with its treasurer, and must be deemed, by implication, to have power to enforce, by action, both settlement and payment, if necessary. But an arbitration of differ-

sense. That they were in fact fraudulently issued could not relieve the defendant treasurer from the obligation which rested upon him to see to it that he paid the same to the persons to whom payment was directed. Had he done this in good faith, we are unable to see why his duty would not have been performed, and in his failure to pay as directed lies the claim that he was negligent. Had the certificates been regularly issued payment upon forged indorsements would not have excused the defendant treasurer, nor could it have relieved the county from a just indebtedness for jurors' services. The liability of the county treasurer for the funds intrusted to his care cannot be allowed to depend upon the fidelity of some other county officer, but is with him alone, and to be determined by his actions. Nor can the right of the county to require of him that he account for the public funds be limited or controlled by the fact that it may also look elsewhere for relief in case of loss. For the bad conduct of the deputy in fraudulently issuing the certificates the county may have a right of action against his principal, the clerk of the court; but it is not confined to that action; it is not obliged to look to him alone. Unless it be upon the theory that as these certificates were issued without the rendition of services, and fraudulently, the payees must necessarily have been fictitious and nonexistent, we do not quite understand the assertion of counsel that no payees were named, and, therefore, the instruments were payable to bearer; or the pertinency of the authorities collated by counsel to the effect that, where a payee's name is left blank in a bill or note when the same issued, such bill or note is in legal effect payable to bearer, and until the payee is actually named the paper will circulate as though made payable to bearer in terms. We have already stated that from the averments of the complaint the presumption is that the payees named were not fictitious or nonexistent, but in any event the weight of authority is that the rule cited by counsel applies only to paper put into circulation by a maker with knowledge that the name of the payee does not represent a real person. Shipman *v.* Bank of New York, 126 N. Y. 318; s. c., 27 N. E. Rep. 371. The rule can have no application to the issuance of county orders or warrants. There is absolutely nothing in the appellant's position that the county is estopped from saying that the payees named were fictitious and the indorsements forged. The wrongful acts of the officers of a municipal corporation cannot create an estoppel against the corporation, the taxpayers, or the people." Citing Mayor *v.* Ray, 19 Wall. 468.

ences is just as legitimate a mode of settlement as by action. Courts, indeed, are disposed to encourage settlements by arbitration. Zook *v.* Spray, 38 Iowa, 273. We may add that such settlements seem to be peculiarly appropriate where arbitrators, possessing more or less of an expert character, can be called into requisition. We presume that the intervenor could not deny that private corporations may submit to arbitration. But, in our opinion, the power may properly enough be exercised by public corporations also. It was held in Dix *v.* Town of Dummerston, 19 Vt. 262, that selectmen, having power to audit and allow claims, might submit to a reference. As having some bearing upon the same question, see, also, Inhabitants of Boston *v.* Brazer, 11 Mass. 447; Brady *v.* Mayor of Brooklyn, 1 Barb. 584."[1]

§ 236. Liability under special provisions of charter or statute.— Where the charter of a corporation makes every director personally liable for the debts of the corporation during his administration to an amount not to exceed a fixed sum, an action in equity may be maintained by a creditor against the directors as it would prevent a multiplicity of suits, and the liability of all the parties interested could be determined in the one suit. In such case the corporation would not be a necessary party defendant when the suit is first brought, nor would it be necessary to make all the creditors parties plaintiff.[2] And it

[1] District Township of Walnut *v.* Rankin, (1886) 70 Iowa, 65, 66, 67.

[2] Bauer *v.* Platt, (1893) 72 Hun, 326; s. c., 25 N. Y. Supp. 426. PARKER, J., speaking for the court said: "The purpose of the provision [of the charter] was not only to insure vigilance on the part of the directors, but to further assure to the creditors of the company payment of their claims. It has for its object the protection of all creditors, not a portion of them. That result might not be effectuated if each creditor should be compelled to resort to an action at law. The liability of each director does not exceed five thousand dollars. If then, each director should suffer judgment to go against him by default, the creditors first suing might recover their entire claims, while others less prompt would not receive anything. If the directors should find that the amount of their statutory liability would not equal the deficiency of the company to its creditors some or all of them might arrange for a preference of creditors by answering, or demurring in some cases, while suffering default in others. By such methods, which even the vigilant prosecutor could not overcome, some creditors might be paid in full while others would receive little or nothing. As the statute was intended for the benefit of all creditors, and all of them, as well as some of them, must be presumed to have trusted in part to the protection assured them by its provisions, it is no more than just

would be of advantage to the directors to bring them all into court on the equity side, as they cannot be decreed to pay more individually than the liability named in the charter and assured by them when they became directors. Besides, such a suit is adapted for their protection in such cases from the possibility of vexatious litigation. If the amount due creditors equals or exceeds the aggregate of the statutory liability of the directors, the judgment decreeing that each make payment of the sum for which he is liable will relieve him from the annoyance and expense of further litigation; on the other hand, if it should prove to be less, the judgment will provide for a ratable payment, and, in addition to the other litigation which would otherwise be threatened, possibly an action for contribution may be avoided.[1] The trustees, directors or managers of any society or corporation organized under the provisions of this New York statute,[2] by a section of that statute are made "jointly and severally liable for all debts due from said society or corporation contracted while they are trustees, provided said debts are payable one year from the time they shall have been contracted, and provided a suit for the collection of the same shall be brought within one year after the debt shall become due and payable." In an action brought against a trustee of a club which was organized under this statute for the recovery of the amount of a promissory note of the club payable at four months from date, it was held by the Court of Common Pleas of the city of New York, in General Term, that a judgment against the corporation was not requisite; also that a judgment against one trustee upon his several liability would not discharge or affect the liability of another trustee.[3] The Supreme Court of New York, in General Term, has sustained the constitutionality of this statute. And they have also held that the creditor under it seeking to charge the trustees need not exhaust his remedy against the corporation before suing the trustees, and

that each creditor should share ratably in the fund which an enforcement of the liability of the directors will produce." The court referred to Board of Supervisors *v.* Deyoe, 77 N. Y. 219; Weeks *v.* Love, 50 N. Y. 568, which followed Bank of Poughkeepsie *v.* Ibbotson, 24 Wend. 473; and Garrison *v.* Howe, 17 N. Y. 458; also to Pfohl *v.* Simpson, 74 N. Y. 137, as directly applicable and controlling in this case.

[1] PARKER, J., in Bauer *v.* Platt, (1893) 72 Hun, 326; s. c., 25 N. Y. Supp. 426.

[2] N. Y. Laws, 1875, chap. 267.

[3] Strauss *v.* Trotter, (1893) 6 Misc. Rep. 77; s. c., 26 N. Y. Supp. 20.

the action may be maintained against any or all of the trustees.[1] They also held that, to create a liability on the part of the trustees of this club (the action being upon promissory notes of the club), they must have been directors of the corporation at the time of the creation of the indebtedness, and that the fact that they were trustees of the club at the time of the giving of the notes, if they were given for a past indebtedness, was not sufficient to charge them with liability.[2] A prior recovery of a judgment against a corporation is not essential to the maintenance of an action to enforce the personal liability of a director where, under the charter of the corporation, every director is made personally liable in an action at law for the corporate debts. And other creditors and directors need not be joined as parties in such actions.[3] The Supreme Court of New York, in General Term, has held that the obtaining of a judgment against a corporation by a creditor, who at the same time was a stockholder and trustee, with the cooperation of the board of the associate trustees, the corporation being insolvent, was a violation of the statute of New York which prohibits the assigning or disposing of its property by any corporation's officers, for the payment of a debt, or from making any transfer in contemplation of insolvency; also that a sale of the property under such a judgment was void as to other judgment creditors.[4] But should there not appear an intent to defraud creditors, except as derived from the statute, and this judgment creditor purchase the property at the sale under his judgment, and afterwards satisfy a given mortgage upon it, besides other outstanding indebtedness of the corporation, the lien of the other judgment creditors would be subject to such mortgage and indebtedness.[5] A provision in a charter of a corporation that, "If the indebtedness of said company shall at any time exceed the capital stock paid in the directors assenting thereto shall be individually liable to the creditors for said excess," has been held by the Tennessee Supreme Court to impose an individual liability upon them for such specific debts only as were con-

[1] Metzger *v.* Carr, (1894) 79 Hun, 258; s. c., 29 N. Y. Supp. 410.

[2] Ibid.

[3] State Bank *v.* Andrews, (Ct. Com. Pl. N. Y. 1893) 2 Misc. Rep. 394; s. c., 21 N. Y. Supp. 948; Merritt *v.* Goodrich, (Ct. Com. Pl. 1893) 2 Misc. Rep. 578; 21 N. Y. Supp. 949.

[4] King *v.* Union Iron Co., (1891) 58 Hun, 601; s. c., 11 N. Y. Supp. 603.

[5] Ibid.

tracted with their assent in excess of the paid-up capital and remain unpaid after the corporate assets are exhausted.[1]

§ 237. Liability under provisions of charter — Pennsylvania.—The charter of a Pennsylvania corporation provided that if the directors failed to make an annual statement of the nature and character of the property of the association, or if they made a false statement, they should be liable for the debts of the corporation. The directors made no statement for three years. They then published a statement, in lumping items only, on the face of which the company was solvent. As a matter of fact the company was insolvent at the time, and two days afterwards a receiver was appointed. In an action against the directors, they filed an affidavit of defense in which they averred that they had made the statement with ordinary care and prudence, and in the belief that the association was solvent. This affidavit of defense was held by the Supreme Court of Pennsylvania to be insufficient to prevent judgment, as the delay in making the statement and its defective character brought the directors within the personal liability clause of the charter.[2]

[1] Allison *v.* Coal Company, (1888) 3 Pickle, (Tenn.) 60; s. c., 9 S. W. Rep. 226. A case illustrating the circumstances under which a by-law of a corporation making the director liable for creating an indebtedness exceeding the amount of the subscribed capital stock would be held to have been waived: Underhill *v.* Santa Barbara Land, Building & Imp. Co., (1891) 93 Cal. 300; s. c., 28 Pac. Rep. 1049.

[2] Githers *v.* Clarke, (1893) 158 Pa. St. 616; s. c., 28 Atl. Rep. 232; 33 W. N. C. 462. The court said: "It is quite clear that their belief that the corporation was solvent was no excuse for their failure to make an earlier statement, and that 'ordinary care and prudence' in making it when they did cannot relieve them from the liability incurred by their delay. They were chargeable with knowledge of the condition of the association, and they ought to have made a true and intelligible statement of it in conformity with the act of assembly. It was a duty the association owed to the public, and the default of their predecessors should have hastened their performance of it. But they neglected to make any statement for three months, and until the association was about to pass into the hands of a receiver, and when they did make one it was defective. It did not set forth with reasonable particularity the 'nature and character of the property of the corporation.' It represented the association as solvent, when in fact it was not able to pay more than ten per cent of its liabilities. It may be true that the directors believed the corporation was solvent, and that the assets were as valuable as represented, but it is very evident that their belief was not warranted by the facts nor consistent with the knowledge of its affairs which the law imputes to them."

§ 238. Statutory liability — California statutes.—To make directors of a corporation personally liable under the provision of the Civil Code of California that "the directors of corporations must not * * * create debts beyond the subscribed capital stock * * *," and then affixes a liability upon them for its violation to the full amount of the debt contracted, it must appear that the corporation must have been indebted at the same time in an aggregate amount exceeding the amount of the capital stock. This statute has been held a penal one and subject to a strict construction against the liability. Under that construction the prohibited debts have been held to be ordinary subsisting debts in excess of the capital stock, and not the aggregate of the debts of the company created during its entire corporate existence. The prohibition applies to debts in excess of all the subscribed capital stock, whether it has all been paid in or only part of it, and regardless of the disposition which may have been made of it. A purchase of mines for the full amount of the capital stock, to be paid for in the stock of the corporation, a portion of which only is paid in, does not make all debts thereafter created in excess of the subscribed capital stock. The subscribed capital stock of a corporation is the fund upon which the transactions of the corporation are to be made, and is a guaranty to creditors that all obligations to that amount will be met; but it cannot be considered as a debt of the corporation, whether paid in or not, in estimating the amount of indebtedness beyond which the directors of the corporation may make themselves personally liable. Debts to be thus considered are only those created by voluntary act of the directors.[1] The directors of a mining corporation are not rendered liable for the penalty imposed by the statute of California requiring the directors of such corporations, on the first Monday of each and every month, to post in the office of the corporation a verified balance sheet for the previous month, and providing that upon their failure so to do they shall be liable in an action by any stockholder in the penal sum of $1,000 for each failure to comply with its requirements. It would seem that under the provisions of the statute the stockholder or stockholders might, at their election, proceed against the directors for a single delinquency, or might forbear to do so until more than one dereliction of duty on the part of their trustees had occurred, but in neither

[1] Moore *v.* Lent, (1889) 81 Cal. 502; s. c., 22 Pac. Rep. 875.

event could more than one penalty be recovered.[1] The statute of California requiring the directors and officers of mining corporations to make and post an account or balance sheet on the first Monday of each month has been held to be mandatory, and the officers and directors of such corporations must be presumed to know at all times the condition of the business and property under their control, and in the absence of a showing of impossibility to have made and posted the account as required, they cannot avail themselves of any presumption that their duty has been performed. Nor can they relieve themselves from liability to a stockholder for liquidated damages under the statute by showing that the account was posted after the time required by law and the day before the commencement of the action.[2]

§ 239. Statutory liability — Colorado statutes.— The directors of a corporation, coming into office after an indebtedness has been created against it, and after the previous board's default in failing to file, as required by the statutes of Colorado, a report showing the amount of the corporate indebtedness, will not be held liable under the general statute which provides "that all the directors or trustees of the company shall be jointly and severally liable for all the debts of the company that shall be contracted during the year next preceding the time when such report should * * * have been made and filed, and until such report shall be made."[3] A complaint against directors of a corporation to enforce their liability under the statutes of Colorado which makes directors and trustees of corporations "liable for all the debts of the company that shall be contracted during the year next preceding the time when such report should by this section have been made and filed and until such report shall be made," referring to the annual report of the amount of its capital and the proportion actually paid in, etc., must aver the contract of indebtedness, the default of the corporation and the directorship of the defendants, and as of such dates to show the liability of the defendants under the statute.[4]

[1] Loveland *v.* Garner, (1887) 71 Cal. 541; s. c., 12 Pac. Rep. 616.

[2] Schenck *v.* Bandmann, (1889) 81 Cal. 231; s. c., 22 Pac. Rep. 654.

[3] Austin *v.* Berlin, (1889) 13 Colo. 198; s. c., 22 Pac. Rep. 433; citing Boughton *v.* Otis, 21 N. Y. 261; Quarry Co. *v.* Bliss. 27 N. Y. 299.

[4] Anfenger *v.* Anzeiger Pub. Co., (1866) 9 Colo. 377; s. c., 12 Pac. Rep. 400. As to construction of the Colorado statutes imposing liability upon officers of corporations for failure to make certain annual reports, and for signing a false report knowing it to be false, see Matthews *v.* Patterson, (1891) 16 Colo. 215; s. c., 26 Pac. Rep. 812.

§ 240. Statutory liability — Iowa statutes.— It must appear, in order to render officers of a corporation liable under the statutes of Iowa for diversion of funds or paying dividends so as to leave insufficient funds to meet liabilities, that the entire property of the corporation is not sufficient to pay its indebtedness.[1] The word "liability" in this statute means existing indebtedness, the payment of which can be enforced. It does not include corporate liability for payments of capital stock, the liability being remote and contingent.[2] There being sufficient assets in the possession of a corporation to pay all its debts at the time a dividend is declared, the payment of a dividend will not be held illegal on a diversion of funds to objects other than those authorized.[3] The statutory provision in Iowa that intentional fraud in failing to comply substantially with the articles of incorporation, or in deceiving the public, that any person who has sustained injury from such fraud may recover damages against those guilty of participating in the fraudulent act, only applies to officers or others guilty of intentional fraud. Hence, in an action to recover from individual officers of a corporation the amount of a judgment against the corporation on the ground that such officers, have rendered themselves liable by fraud, they will be relieved from liability by a proof of the absence of intentional fraud and diversion of assets to their own use.[4] In an action for damages under this statute, the particular respect in which there was a failure to comply with the articles of incorporation resulting in damages to the complainant, or the particular act of deception, must be specified.[5] Under the statute of Iowa making the directors of a railroad company receiving taxes in aid thereof liable to any of its stockholders in double the amount of the par value of his stock in the event of their voting to bond or mortgage the road to exceed certain fixed amounts per mile, the Supreme Court of Iowa held that no liability on the part of the directors arose where such an incumbrance was voted prior to the voting of the tax, and the mortgage was executed and recorded before the tax in aid of the railroad was collected and paid to the company.[6]

[1] Miller *v.* Bradish, 69 Iowa, 278.

[2] Ibid.

[3] Ibid.

[4] Hoffman *v.* Dickey, 54 Iowa, 135.

[5] White *v.* Hosford, 37 Iowa, 566.

[6] Walker *v.* Birchard, (1891) 82 Iowa, 388.

§ 241. Statutory liability — Massachusetts statutes.— The statute of Massachusetts makes the officers of a corporation jointly and severally liable for the debts of the corporation in case there are false statements in the certificate of the condition of the corporation which they are required by law to make at certain stated times.[1] A tax is a debt within the meaning of that statute.[2] The directors and officers signing a certificate of the condition of the corporation, knowing it to be false, are liable for the debts of the corporation then existing, as well as for debts incurred thereafter.[3] But under this Massachusetts statute directors cannot be made liable for the debts of a corporation, unless the certificate required by law be willfully false.[4] Debts due from a corporation to one of the directors are debts within the meaning of the Massachusetts statute making the president and directors of a corporation liable to the extent of the excess of its debts over its capital.[5] On a bill brought to enforce this liability by a judgment creditor, the plaintiffs may prove, not only their judgment debt, but a further sum due them on simple contract.[6] Where the debts of the corporation exceed the capital a director of the corporation, who is also a creditor, cannot share with other creditors, who are not directors, in the amount which he, or he

[1] Pub. St. Mass. chap. 106, §§ 54, 60.

[2] Felker *v.* Standard Yarn Co., (1889) 148 Mass. 226; s. c., 19 N. E. Rep. 220.

[3] Ibid. It was said by the court: "And no doubt one important reason, perhaps the principal reason, for the statutory provisions is to enable persons who may have occasion to deal with corporations to ascertain their condition, and their title to credit, so that a person whose debt already exists at the time of the filing of the certificate certainly has not, by any false statements contained therein, been misled into giving credit to the corporation, and may not in any way be injured thereby. But in imposing the penalty of liability for its debts and contracts, the statute is not limited to such debts and contracts as were created in favor of persons who had examined and been misled by the false certificate, as it should be if the idea of the defendant were followed out. It is not even limited to debts and contracts which come into existance after the filing of the certificate, but is general in its terms, and provides that the officers who knowingly make the false certificate 'shall be jointly and severally liable for its debts and contracts.' Pub. St. Mass., chap. 106, § 60. The construction of this language includes existing debts and contracts, and we find nothing elsewhere sufficient to show that the legislature meant otherwise."

[4] Felker *v.* Standard Yarn Co., (1889) 150 Mass. 264; s. c., 22 N. E. Rep. 896.

[5] Thacher *v.* King, (1892) 156 Mass. 490; s. c., 31 N. E. Rep. 648.

[6] Ibid.

and other directors, may be compelled to pay towards the debts of the corporation in consequence of such excess under this statute.[1] The statute of Massachusetts making officers of corporations jointly and severally liable for the debts thereof, when they exceed the capital, "to the extent of such excess existing at the time of the commencement of the suit against the corporation upon the judgment in which the suit in equity to enforce such liability is brought," has had the consideration of the federal court for the district of Vermont, and the court construed the statute and held the liability under it, before suit brought to fix it, not to be a debt, nor any fixed obligation to pay, but only that from which, by the prescribed course, an obligation to pay might be raised.[2]

§ 242. Statutory liability — Minnesota statutes.— There is a statute in Minnesota to this effect: "If any corporation organized and established under the authority of this act shall violate any of its provisions, and shall thereby become insolvent, the directors ordering or assenting to such violation, shall be jointly and severally liable in an action founded on this statute for all debts contracted after such violation as aforesaid."[3] The Supreme Court of Minnesota held that the *ultra vires* acts of the directors of the corporation in the case before them in executing accommodation paper in the name of the corporation, and in lending the funds of the corporation to others, constituted a

[1] Ibid.; citing Potter *v.* Stevens Machine Co., 127 Mass. 592; Thayer *v.* Union Tool Co., 4 Gray, 75, 79; Merchants' Bank *v.* Stevenson, 10 Gray, 232; Cambridge Water Works *v.* Somerville Dyeing & Bleaching Co., 4 Allen, 239; Merchants' Bank *v.* Stevenson, 5 Allen, 398, 401, 402, and 7 Allen, 489; First National Bank *v.* Hingham Manufg. Co., 127 Mass. 563.

[2] Knower *v.* Haines, (1887) 31 Fed. Rep. 513. WHEELER, J., said: "No liability of officers or stockholders of a corporation exists at common law, but only by statutes of the sovereignty creating it. When so created, it exists only as created, and can be enforced only as provided by such statutes when they make provision for that purpose. Pollard *v.* Bailey, 20 Wall. 520; Fourth National Bank *v.* Franklyn, 120 U. S. 747; s. c., 7 Sup. Ct. Rep. 757. Such a liability under a statute like this, before suit brought to fix it, is not a debt, nor any fixed obligation to pay, but is only that from which, by the prescribed course, an obligation to pay may be raised. Ripley *v.* Sampson, 10 Pick. 371; Bangs *v.* Lincoln, 10 Gray, 600. This is different from cases where the law raises the liability from the acts of the officers or stockholders and leaves it to be enforced by the appropriate remedy. Windham Provident Inst. *v.* Sprague, 43 Vt. 502."

[3] Laws Minn. 1873, chap. 11, § 23 (Gen. Sts. Minn. 1878, chap. 34, § 142.)

violation of the statute "by the corporation" within its meaning. As to the "assent" required to make a director liable, they held that to constitute "assent" there must be something more than mere negligence on the part of a director in not knowing what, in the exercise of proper care, he ought to have known. There must be some willful or intentional violation of duty — assenting to it, knowing that the act is being or about to be done. But if, with such knowledge, he neither objects to nor opposes it when his duty requires, and when he has the opportunity of doing so, this would be "assent." Further, if a series of acts or a continuous course of conduct on the part of the directors, in violation of the statute, finally producing the insolvency of the corporation, is begun before the debt of a creditor is contracted, the debt is one contracted "after such violation," although the series of acts or course of conduct is not completed or the insolvency of the corporation consummated until afterwards.[1] These rules were declared as to actions to enforce this liability under the statute, to wit: A creditor of the corporation may sue one or more of the directors to enforce the liability without joining all the creditors to whom they are liable, or all the directors subject to the liability. His right of action is neither taken away nor suspended by the fact that the affairs of the corporation may have been placed in the hands of a receiver. Nor is it necessary that the creditor sue the corporation and obtain judgment against it before suing the directors. The corporation, if necessary, may be joined as co-defendant with the directors, and the creditor may establish his claim against the corporation in the same action.[2]

§ 243. Statutory liability — Missouri statutes. — The Supreme Court of Missouri has held that under the statute of that state making directors of corporations, where they have allowed the debts of the corporation to exceed the amount of capital stock paid in, jointly and severally liable to the extent of such excess for all debts of the corporation then existing, and for

[1] Patterson *v.* Stewart, (1889) 41 Minn. 84; s. c., 42 N. W. Rep. 926.

[2] Ibid. The court commented upon the following cases which are of different kinds to enforce liability of stockholders and officers: Dodge v. Minnesota Plastic Slate Roofing Co., 16 Minn. 368; Merchants' National Bank *v.* Bailey Manufacturing Co., 34 Minn. 323; s. c., 25 N. W. Rep. 639; Allen *v.* Walsh, 25 Minn. 543; Johnson *v.* Fischer, 30 Minn. 173; s. c., 14 N. W. Rep. 799; Bassett v. St. Albans Hotel Co., 47 Vt. 313; Hornor *v.* Henning, 93 U. S. 228.

all that should be contracted so long as they continued in office, etc., were liable in an action to recover a debt contracted under such circumstances, notwithstanding one of the firm owning the debt was a stockholder in the corporation.[1] The debts for which directors of a corporation will be held liable under this Missouri statute are the debts voluntarily incurred by the directors.[2] A judgment against a corporation for damages for a loss of a steamboat, for instance, through the negligence of the agents and servants of the corporation would not be one of the debts contemplated by the statute.[3]

§ 244. Statute of New York — liability for failure to file annual report. — Under the statutes of New York, making the directors of certain corporations liable for the debts of the corporation in case they fail to file with the secretary of state the

[1] Anderson *v.* Blattau, 43 Mo. 42. The court distinguished Kritzer *v.* Woodson, 19 Mo. 327, in these words: "That was a case where a stockholder in a corporate company sued the directors to recover back an amount which he had been compelled to pay to the creditors of the company. The law made him liable to the extent of double the amount of stock in the company. Its entire assets having been exhausted, he was compelled to pay the creditor of the company the amount which he sought to recover in that suit upon the ground that the debts of the corporation had been suffered to accumulate to an amount in excess of the capital stock actually paid in. But the court said this statute was given for the protection of creditors and not the individual members of the company. It is true that for any improper management of the affairs of the company, by which a liability might be incurred on the part of the directors to the individual members, an action could be maintained against them. Such liability, however, exists independent of this statute. It is clear that the point decided in that case was that the statute was intended for the protection of such parties as really held debts against the company. The stockholder, by discharging an obligation which the law imposed upon him, could not make himself the creditor of the corporation. His claim was in no sense a debt due by the company, and hence it was not covered by the provisions of a statute made for a different purpose altogether. This [claim in suit here] seems to have been a debt contracted by the company in the prosecution of its business, and the liability of the defendants cannot be affected by the fact that one of the plaintiffs was a stockholder. Certainly the interests of his copartner ought not to suffer on account of his relation to the corporation. The objection differs in no essential particular from any other incurred by the company; and if it was due and owing to the stockholder alone, we can see no good reason for depriving him of the protection intended to be given to all creditors alike."

[2] Cable *v.* Gaty, 34 Mo. 573, affirming Cable *v.* McCune, 26 Mo. 371.

[3] Cable *v.* Gaty, 34 Mo. 573, affirming Cable *v.* McCune, 26 Mo. 371.

annual report required as to the amount of its capital stock and the proportion actually paid in, the amount, and, in general terms, the nature of its existing assets and debts, and the names of its then stockholders, and the dividends, if any, declared since the last report,[1] the directors become liable for all the debts of the corporation during the term of directorship if they fail to make and file the report. So long as the default lasts, the other essentials existing, there is no distinction between directors in office at the time of default and those subsequently elected. An incoming director, having the power to protect himself from liability by filing a report, his failure to do so imposes a liability for debts contracted during his term.[2] Where there is proof in such a case that there was a corporation which assumed to act and carry on business, having a general manager, directors and by-laws, the directors against whom the action is brought cannot defend on the ground that there was no legally organized corporation.[3] Operating as a penalty, a recovery cannot be had of the trustees for failure to file a report under such statutes, in case the statute be repealed, expressly or by implication, before the trial of the case.[4] Creditors residing in other states than New York have the same rights as resident creditors to enforce the liability of the trustees for failing to make the required annual report under this statute.[5] In a case where the number of trustees of a manufacturing corporation organized under the laws of New York had been practically reduced to nine from twelve, and the annual report required to be filed had been signed by six of the trustees, it was claimed that the trustees had become liable for the debts of the corporation as a penalty for not filing the report, inasmuch as the report filed had not been signed by a majority of twelve trustees. The New York Court of Appeals held that the law had

[1] Laws N. Y. 1875, chap. 611, § 18.

[2] Buck *v.* Barker, (Buffalo Super. Ct. Spl. Term, 1887) 5 N. Y. St. Repr. 826; citing Jones *v.* Barlow, 62 N. Y. 202; Cameron *v.* Seaman, 69 N. Y. 396, 402; Boughton *v.* Otis, 21 N. Y. 261; Garrison *v.* Howe, 17 N. Y. 464, 465; Quarry Co. *v.* Bliss, 27 N. Y. 297–300; Chandler *v.* Hoag, 2 Hun, 613; affirmed in 63 N. Y. 624.

[3] Buck *v.* Barker, (Buffalo Super. Ct. Spl. Term, 1887) 5 N. Y. St. Repr. 826; citing Buffalo & Allegany Railroad *v.* Cary, 26 N. Y. 75; Aspinwall *v.* Sacchi, 57 N. Y. 331–338; Meriden Tool Co. *v.* Morgan, 1 Abb. N. C. 125, note.

[4] Victory Webb Printing Co. *v.* Beecher, (1881) 26 Hun, 48; affirmed in 97 N. Y. 651; followed in Carr *v.* Risher, (1888) 50 Hun, 147.

[5] Sears *v.* Waters, (1887) 44 Hun, 101.

been complied with in filing this report; that the proceedings of the board, in the matter of reducing the number of members, concurred in by all having an interest in the corporation, effected a practical reduction, and constituted the nine thereafter elected a *de jure* as well as a *de facto* board. Further, that it seemed that the question of the legality of the change in the constituency of the board could only be raised in a direct proceeding by one whose interests were affected. And the trustees as constituted having complied with the letter and spirit of the law, in filing the report, it was not competent in this action against them to enforce a liability for non-compliance with the statute for plaintiff to show that some of the acting trustees were not elected or for some reason were disqualified from acting, or to claim that, by reason of a non-performance or an irregularity in the performance of some prior duty enjoined upon the stockholders, the board as constituted had no authority to perform the general duties required of them as agents of the corporation.[1] In a case before the New York Court of Appeals it appeared that an annual report was properly made out and signed by the trustees of the corporation in the time required by the statute, but by inadvertence or mistake of the secretary was not filed in time. Within a month afterwards there was an application made to the Supreme Court for leave to file it and an order of the court that it be filed *nunc pro tunc*. The Court of Appeals held that this order of the court did not of itself relieve the trustees sued from liability; that the duty to file the report was imposed by statute upon the corporation, and over it the court had no jurisdiction. The application was an act by the trustees in supposed furtherance of their duty and was an indication of good faith in respect to the proper disposition of the report, being an effort to do that which the corporation had not done.[2] Under the construction of this section of the statute, in Cameron *v.* Seaman,[3] where it was held that the limitation of twenty days applied only to the act of making, and did not apply to the act of filing or publishing; that, as to those acts, the section was directory, but as the object of the act was to insure a speedy and public disclosure of the contents of the report, it was said that the law, in the absence of an express pro-

[1] Wallace & Sons *v.* Walsh, (1890) 125 N. Y. 26; s. c., 25 N. E. Rep. 71.

[2] Butler *v.* Smalley, (1886) 101 N. Y. 1076.

[3] 69 N. Y. 396.

vision on the subject, implies that both filing and publication should be within a reasonable time after the twenty days, and that this requirement exacted prompt performance and diligent action on the part of the trustees, the Court of Appeals held that in this case the referee erred in refusing to find that whether the filing of the report was within a reasonable time after the expiration of the twenty days would depend upon the circumstances; also, that he erred in finding that there was neither prompt performance nor diligent action on the part of the company with respect to the filing of the report.[1] Where the certificate of incorporation was signed by seven trustees and acknowledged by nine, the provision of the statute which requires an annual report to absolve the trustees from personal liability for the debts of the corporation to be signed by a majority of the trustees would not be satisfied by an annual report signed by two trustees, where it is not shown by an official record that neither one of the trustees had resigned.[2] A manufacturing corporation which has never commenced business, and where, before the time prescribed for making the report required under the statute has elapsed, the object for which the corporation was formed becomes impossible of accomplishment by it, and it is neither able nor intends at any time to prosecute

[1] Butler *v.* Smalley, (1886), 101 N. Y. 71, revg. 49 N. Y. Super. Ct. 492. DANFORTH, J., said: "To prepare a report for filing and publication, to place it in good faith in the hands of the secretary for deposit in the clerk's office and in the office of a newspaper, is at least equal in significance to a delivery of a report to a mail agent for transmission to those places. In the one case as in the other the company avails itself of the usual methods of performing its duty, and in the absence of anything to show the want of good faith and active diligence in respect thereto on its part, a trustee, when no time is fixed by statute within which an act shall be performed, should not be subjected to a penalty, provided the thing required is actually done at a reasonable time, having regard to the nature and circumstances of the performance."

[2] Westerfield *v.* Radde, (1884) 67 How. Pr. 204. In Whitney *v.* Cammann, (1892) 60 N. Y. Super. Ct. 391; s. c., 18 N. Y. Supp. 200; affirmed in Whitney *v.* Cammann, (1893) 137 N. Y. 342; s. c., 33 N. E. Rep. 305, the court referred to Cameron *v.* Seaman, 69 N. Y. 396, and Butler *v.* Smalley, 101 N. Y. 72; s. c., 4 N. E. Rep. 104, and held that while these cases held that substantial instead of literal compliance with the requirement as to the filing of the annual report, as where the report was filed within a few days after the prescribed time, yet the failure to comply with the statute for a year clearly brought the trustees in this case within the mischief of the statute and subjected them personally to the liability imposed by the statute.

its business, is not required to make such a report, and no liability under the statute attaches to the trustees for failure to make it.[1] The statutes of New York making the trustees of manufacturing corporations liable for the debt of the corporation for failure to file an annual report, it has been held that the liability does not depend upon the fact that defendant was a trustee when the debt was incurred, but upon his having been a trustee when the default in filing the report occurred. So where one may have resigned after the incurring of the debt, but before the default complained of, he would not be held liable.[2] A report made by the trustees of a manufacturing corporation, as required by the statute, stating the amount of the capital, and that all of it had "been paid in in cash, patent rights, merchandise, machinery accounts, etc., necessary to the business and for which stock to the amount of the value thereof has been issued by the company," has been held by the Court of Appeals to be a sufficient compliance with the requirement of the act; further, that it is not necessary, in the annual report required to be filed by the trustees under this statute, to specify therein how much of the capital stock was paid in in cash and what amount in property.[3]

§ 245. Actions to enforce this liability.— Under this statute the action may be brought against such of the trustees as the plaintiff may select; and if there are three or more such trustees, for instance, and the action be brought against two, the nonjoinder of the others would not constitute a defense.[4] In case a defendant in such an action be a trustee whose election is not legally valid, where, as matter of fact, he was in form elected a trustee by those who had the right to elect one, if there was a vacancy to be filled, and thereafter acted as trustee, and while acting as such there was a failure to make and file the report required by the statute, the court held him liable on any such default between the time of his election and his resignation; also

[1] Kirkland *v.* Kille, (1885) 99 N. Y. 390.

[2] Bruce *v.* Platt, (1880) 80 N. Y. 379. As to this statute being a penal statute, see Merchants' Bank *v.* Bliss, 35 N. Y. 412; Garrison *v.* Howe, 17 N. Y. 458; Adams *v.* Mills, 60 N. Y. 536, 553; McHarg *v.* Eastman, 35 How. Pr. 205; s. c., 7 Robt. 137.

[3] Whitaker *v.* Masterton, (1887) 106 N. Y. 277, holding the action against the trustees not maintainable. Citing Bonnell *v.* Griswold, 80 N. Y. 128, 135; Brackett *v.* Griswold, 103 N. Y. 425.

[4] Halstead *v.* Dodge, (1884) 51 N. Y. Super. Ct. 169; s. c., 1 How. Pr. (N.S.) 170; citing Strong *v.* Sproul, 4 Daly,

that he was not exempted from liability by reason of his not being a stockholder.[1] In an action under this statute brought against several trustees to enforce their liability for failure to make the annual report as required for a debt of the corporation, where there is a failure to serve one or more of the defendants the case may proceed against those served, as the action is upon a joint and several liability and for a penalty, and not upon the contract.[2] This statute is penal, and not to be extended by construction. In an action to enforce a liability created by it, nothing can be presumed against the trustees sought to be charged, but every fact necessary to establish their liability must be affirmatively proved.[3] The failure to file a report making the trustees jointly and severally liable for all the debts of the corporation, the fact that the corporation may be indebted to a trustee would not be a defense to the action.[4] In an action against the trustees of a corporation to charge them with an indebtedness of the corporation, and on the trial there be proved the original indebtedness, and that it had been reduced to judgment, and the execution upon the judgment returned unsatisfied, the trustees would not be concluded in any respect by the judgment against the corporation, they being neither parties nor privies to the action, and should be allowed to prove any defense arising subsequent to the accruing of the debt.[5]

326; Quigley *v.* Walter, 2 Sweeny, 175.

[1] Ibid.

[2] Geisenheimer *v.* Dodge, (1884) 1 How. Pr. (N. S.) 264.

[3] Bruce *v.* Platt, (1880) 80 N. Y. 381; followed in Tovey *v.* Culver, (1887) 54 N. Y. Super. Ct. 404. See, also, Miller *v.* White, 50 N. Y. 137; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62. As to not being necessary to obtain a judgment against the corporation before action against trustee, see Green *v.* Easton, (1893) 74 Hun, 329; s. c., 26 N. Y. Supp. 553. As to pleading in actions against trustees for failing to file annual report under the New York statute, see Wilson Manufacturing Co. Schwind, (N. Y. Sup. Ct. Spl. Term, 1893) 5 Misc. Rep. 205; Straus *v.* Sage, (N. Y. Com. Pl. Spl. Term, 1893) 5 Misc. Rep. 255; Smith *v.* Sage, (N. Y. Super. Ct. Spl. Term, 1893) 5 Misc. Rep. 257.

[4] Morey *v.* Ford, (1884) 32 Hun, 446.

[5] Kraft *v.* Coykendall, (1884) 34 Hun, 285; citing Miller *v.* White, 50 N. Y. 137; Stephens *v.* Fox, 83 N. Y. 317; Rorke *v.* Thomas, 56 N. Y. 565; Jones *v.* Barlow, 62 N. Y. 202–205. Dissenting opinion of DANIELS, J., in Tyng *v.* Clarke, 9 Hun, 274; Esmond *v.* Bullard, 16 Hun, 67; affirmed in 79 N. Y. 404; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62. As to judgment against corporation prior to suit to enforce personal liability of directors not being necessary, see Strauss *v.* Trotter, (Com. Pl. N. Y., 1894) 6 Misc. Rep. 77; s. c., 26 N. Y. Supp. 20.

§ 246. What are and what are not "debts" for which liability under this statute may arise.— An unliquidated claim, arising out of a breach of contract of employment at the time of the failure of a manufacturing corporation to file the annual report required by the New York statute, is a debt within the meaning of the statute imposing a personal liability upon the trustees for all "debts" of a corporation which fails to file an annual report.[1] And in such an action, upon such a claim, the recovery of the holder of the claim will be limited to the amount of damages he may have recovered from the corporation.[2] The holder of bonds issued by a manufacturing corporation, having knowledge that such bonds were diverted from the purpose for which they were intended and authorized, cannot enforce the liability of trustees for the amount of his bonds as a "debt" within the meaning of this statute.[3] A judgment for costs, recovered against the corporation in an action for trespass brought by it, is such a "debt" within the meaning of the statute as the trustees of the corporation will be liable for in case they fail to file the required report.[4] It *seems*, however, that in such a case it would be open to the trustees sued to show that the recovery of

[1] Green *v.* Easton, (1893) 74 Hun, 329; s. c., 26 N. Y. Supp. 553; citing New Jersey Ins. Co. *v.* Meeker, 37 N. J. Law, 300, 301; Frazer *v.* Tunis, 1 Bin. 254–262; Mill Dam Foundry *v.* Hovey, 21 Pick. 417, 454, 455.

[2] Green *v.* Easton, (1893) 74 Hun, 329; s. c., 26 N. Y. Supp. 553.

[3] Kirkland *v.* Kille, (1885) 99 N. Y. 390.

[4] Allen *v.* Clark, (1888) 108 N. Y. 269, revg. 43 Hun, 377. EARL, J., said: "This judgment clearly was one of the debts which the company was bound to include among its 'existing debts' in the report which it was required to make, file and publish within twenty days after the 1st day of January, 1886. The section requires the report to state the amount of all of its existing debts of every nature, and it is the clear meaning of the section that if such report be not made the trustees shall be personally liable for all debts which the company was thus bound to report. It may be inferred that it was the purpose of the lawmakers to require this report to be made, published and filed for the information, benefit and protection of existing creditors of the company not only, but of all persons who might thereafter enter into contract relations with it. It may also have been the purpose of the lawmakers to require the report from every manufacturing corporation as a check upon extravagance and mismanagement of its affairs by its trustees, by constantly keeping before them the reminder that at least once a year the affairs of the company are to be exposed to the public view. It may also be supposed that the reports were required so that information might be readily obtained by assessors for the purpose of taxation, and by other public officials who might have occasion to supervise the conduct of the corporation, or to proceed against it for any purpose whatever; and, therefore, to

the costs in the action was either collusive or fraudulent. The debt created by the judgment would be proven by the production of the judgment, which would be at least *prima facie* evidence of its existence.[1] There was a contention in this case before the New York Court of Appeals that the words in the clause of the statute, "and for all that shall be contracted for before such report shall be made," limited the meaning of the words, "debts of the company then existing," in the clause preceding it, to such debts of a corporation as are voluntarily contracted. The court held adversely to this contention, and said: "The word 'contracted' here means the same as 'incurred,' and includes every debt for which the corporation becomes bound. There is no apparent reason for any discrimination as to the kind of debts, and we do not think any was intended."[2] Causes of action for breaches of contract, and causes incidentally arising or resulting from such breaches on the part of the corporation, are not "debts" within the meaning of those statutes making trustees liable for debts of corporations for not filing the required annual report.[3] Where a trustee of a corporation owes a debt against it, and assigns it to another absolutely for value, the assignee of such debt, on a default in making and filing a report under the New York statute, subsequently occurring, may proceed against the trustees to recover the debt on their statutory personal liability, notwithstanding the assignor of the debt to him may have continued to be a trustee up to the time of the default.[4] Where the existence of a corporation, by the terms of its certificate, ends, and there is not at that time a debt in favor of another against it, there can be no liability of directors for not filing an annual report, as required,

make sure of the accomplishment of these important purposes, the trustees are made personally liable for all the debts of the company, in case of the failure of the company within the time specified to make the report."

[1] Allen *v.* Clark, (1888) 108 N. Y. 269. The court distinguished Miller *v.* White, 50 N. Y. 137, where the judgment was upon a debt antecedently existing, in which case it was held that the judgment was neither conclusive nor *prima facie* evidence of the debt, and that it was the duty of the plaintiff to prove and establish his debt independently of the judgment, by saying: "The reason upon which that decision is based can have no application to a case like this, where there was no liability on the part of the company to pay the costs antecedently or independently of the judgment."

[2] Allen *v.* Clark, (1888) 108 N. Y. 269, 275.

[3] Victory Webb Printing Co. *v.* Beecher, (1881) 26 Hun, 48; citing Oviatt *v.* Hughes, 41 Barb. 541; Whitney Arms Co. *v.* Barlow, 68 N. Y. 34.

[4] Cornell *v.* Roach, (1886) 101 N. Y. 373.

for what may, at a later date, by the terms of the contract with the corporation, become a debt under that contract.[1] Under the provision of the statute of New York that, for failure to file the annual report of the capital and indebtedness of any corporation, as therein prescribed, the trustees shall be liable for all debts of the corporation then existing, or contracted before such report be filed, the trustees cannot be subjected for an alleged liability of the corporation accruing on an accommodation indorsement, which the corporation, under its charter, had no authority to make and was not bound by.[2] Trustees of a corporation, organized for manufacturing purposes under the statutes of New York, cannot be subjected to an alleged liability of the corporation accruing on an accommodation indorsement which, under its charter, it had no authority to make, and which, consequently, did not bind it.[3] Where the annual report required to be filed under the New York statute before January twentieth has been filed before the maturing of a note which has been indorsed by a corporation for the accommodation of the maker, there will be no liability of the trustees growing out of the accommodation indorsement for the failure to file the report. This being a conditional liability, it was never incurred, and created no liability before it matured.[4] A contract obligation to pay a singer employed for a specified time by the corporation at a specified salary, is a "debt" of the corporation from the time the contract goes into effect, within the meaning of this statute, for which a director may become liable.[5]

§ 247. A United States Supreme Court decision on this subject.— There was an attempt in an action which came before the Supreme Court of the United States to recover of the trustees of a corporation the amount of a judgment against the corporation under the provisions of the statute of the state of New York,

[1] Gold *v.* Clyne, (1890) 58 Hun, 419; s. c., 12 N. Y. Supp. 531; affirmed in Gold *v.* Clyne, (1892) 134 N. Y. 262; s. c., 31 N. E. Rep. 980. For another illustration of circumstances as to the debt under which the trustees could not be held liable, see Sherman *v.* Slayback, (1890) 58 Hun, 255; s. c., 12 N. Y. Supp. 291. Also, Chapman *v.* Comstock, (1890) 58 Hun, 325; s. c., 11 N. Y. Supp. 920.

[2] National Park Bank *v.* Remsen, (1890) 43 Fed. Rep. 226.

[3] Ibid.

[4] Witherow *v.* Slayback, (1895) 11 Misc. Rep. 526; s. c., 32 N. Y. Supp. 746.

[5] Brandt *v.* Godwin, (1889) 3 N. Y. Supp. 807.

whereby trustees of corporations formed for manufacturing, mining, mechanical or chemical purposes are made liable for debts of the corporation on failure to file the reports of capital and of debts required by that section of the statute. The Supreme Court held that the provision of the statute under which the liability of the trustees, it was claimed, existed on account of a failure to file such a report, was penal in its character, and that it must be construed with strictness as against those sought to be subjected to its liabilities; and, upon this rule of construction, the judgment roll was not competent evidence to establish a debt due from the corporation to the plaintiff; further, it was held that a claim in tort against a corporation found under that statute, as amended, was not a debt of the corporation for which the trustees might become liable under the provisions of the statute above stated.[1]

[1] Chase *v.* Curtis, (1885) 113 U. S. 452; s. c., 5 Sup. Ct. Rep. 554. Mr. Justice MATTHEWS, in the opinion, speaking for the court, said: "It is the well-settled rule of decision, established by the Court of Appeals of New York in numerous cases, that this section of the statute, to enforce which the present action was brought, is penal in its character and must be construed with strictness as against those sought to be subjected to its liabilities." Merchants' Bank *v.* Bliss, 35 N. Y. 412; Wiles *v.* Suydam, 64 N. Y. 173; Easterly *v.* Barber, 65 N. Y. 252; Knox *v.* Baldwin, 80 N. Y. 610; Veeder *v.* Baker, 83 N. Y. 156; Pier *v.* George, 86 N. Y. 613; Stokes *v.* Stickney, 96 N. Y. 323. In the case last cited the action authorized by it was held to be *ex delicto*, and that it did not survive as against the personal representative of a trustee sought to be charged. In Bruce *v.* Platt, 80 N. Y. 379, it was said: "It is settled by repeated decisions applicable to this case that the statute in question (Laws N. Y. 1848, chap. 40, § 12) is penal and not to be extended by construction; that in an action to enforce a liability thereby created, nothing can be presumed against the defendants, but that every fact necessary to establish their liability must be affirmatively proved." Citing Garrison *v.* Howe, 17 N. Y. 458; Miller *v.* White, 50 N. Y. 137; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62. This rule of construction in reference to this and similar statutory provisions has been heretofore adopted and applied by this court. Steam Engine Co. *v.* Hubbard, 101 U. S. 188; Flash *v.* Conn, 109 U. S. 371. In the case last mentioned, this court, following the Court of Appeals of New York in the case of Wiles *v.* Suydam, 64 N. Y. 173, showed the distinction between the liability of stockholders for the debts of the corporation, under a section of the same act, making them severally individually liable for the debts and contracts of the company to an amount equal to the amount of stock held by them respectively, until the whole amount of the capital stock fixed and limited by the company had been paid in, and the liability imposed upon the trustees by the section now under discussion. It was held that the former was a liability *ex contractu*, enforceable beyond the jurisdiction of the state, and that the statute should be construed liberally in furtherance of the remedy; that the latter was for the enforcement of a penalty, and subject to all rules applicable to actions upon statutes of that description. The distinction is illustrated and enforced in Hastings *v.* Drew, 76 N. Y. 9, and Stephens *v.* Fox, 83 N. Y. 313. The present question involved here was decided by the Court of Appeals of New York in the case of Miller *v.* White, 50 N. Y. 137. In that case the complaint set forth the recovery of a judgment against the company, but not the original cause of action against it on which the judgment was founded. The defendant moved for a dismissal on this ground, which was refused, and judgment was rendered in favor of the plaintiff on the production in evidence of the judgment roll. This was held to be erroneous on the ground that the judgment was not competent as evidence of any debt due from the corporation, and that no action could be maintained thereon against the trustees under this section of the act. Judge PECKHAM, delivering the unanimous opinion of the court, said: "It will be perceived that this is a highly penal act, extremely rigorous in its provisions. It is absolute that the trustees shall be liable for all the debts of the company, if the report be not made, no matter by whose default. If one of the trustees did all in his power to have it made, yet if the president, or a sufficient number of his co-trustees to constitute a majority declined to sign it, or if the president and secretary declined to verify it by oath, the faithful trustee seems to be absolutely liable as well as those who refuse to do their duty." It was accordingly held "that, as against these defendants, the judgment did not legally exist, as they were neither parties nor privies to it. * * * 'It is not a judgment as to those defendants; no action could be maintained thereon against them, * * * nor is the judgment *prima facie* evidence of the debt as against the defendants.'" This doctrine was repeated and reaffirmed by the same court in Whitney Arms Co. *v.* Barlow, 63 N. Y. 62–72. In that case the court said: "The debt must be proved by evidence competent against the defendants. The facts upon which the debt is founded must be proved. The naked admissions of the corporation or judgment against the corporation are not evidence against the trustees. They are *res inter alios acta;* but, when facts are proved which establish the existence of a debt against the corporation, the liability of the trustees for the debt follows upon the proof of the other facts upon which the liability is made by statute to depend." The case of Miller *v.* White, 50 N. Y. 137, has never been overruled nor questioned by the New York Court of Appeals. On the contrary, it has been repeatedly and expressly cited and approved, and either followed or distinguished from the case under decision in the following cases: Rorke *v.* Thomas, 56 N. Y, 559–565; Hastings v. Drew, 76 N. Y. 9–15; Stephens *v.* Fox, 83 N. Y. 313–317; Knox *v.* Baldwin, 80 N. Y. 610–613; Bruce *v.* Platt, 80 N. Y. 379–381.

§ 248. Statute of New York — liability for creation of debts in excess of capital stock. — Under the New York statute making the trustees of manufacturing corporations who assent to the creation of an indebtedness exceeding the amount of the capital stock personally liable for the excess,[1] the liability

[1] Laws N. Y. 1848, chap. 40, § 23.

is one of contract and not of penal liability.[1] And the trustees assenting to the creation of indebtedness exceeding the capital stock will be personally and individually liable for such excess to the creditors of the corporation to whom such excess may be owing.[2] In a case before the Supreme Court of New York the

[1] Patterson *v.* Robinson, (1885) 37 Hun, 341. LANDON, J., for the court said: "The assenting trustee, knowing that the indebtedness of the company has reached at least an amount equal to the capital stock, concurs with the company in contracting further indebtedness. He knows that the statute, in case he assents, makes him also liable. He gives his consent and thereby, under the statute, pledges his liability. The statute says to the assenting trustee, 'you may contract as many debts as you choose to become liable for.' It was insisted that the language of section 13 of the act was similar to that of section 23, and, as the liability under the former was, by settled law, a penal one, the same must be true under the latter." Referring to section 13, which makes trustees liable for declaring dividends, the payment of which would make the corporation insolvent, it was said: "The section seeks to deter the trustee from despoiling the company to the profit of the stockholder and to the ruin of the creditors. Such a wrong has no connection with the contracting of the debt, but imperils its payment and the liability affixed upon the offending trustee may well be called a penalty. There is no such flagitiousness in the act of assenting to an excess of indebtedness over the amount of the capital stock. It may be wise and right; at any rate the intent may be honest. Why affix a penalty upon performance of a good act? Such is not the policy of the law. It may lead to reckless speculation, but speculation is no offense, and the statute prudently tempers the venture for gain by making the assenting trustee a partner with the company in the risk of loss, or, more accurately, in liability to such creditor. And, if this view be correct, the creditor for the excess cannot be deprived of his recourse to the assenting trustee by any decrease in the aggregate indebtedness of the company, or otherwise than by his own consent, or by payment to him."

[2] Ibid.; affirming, and reaffirming on a rehearing. Patterson *v.* Robinson, (1885) 36 Hun, 622. The court distinguished Hornor *v.* Henning, 93 U. S 228; Merchants' Bank of Newburyport *v.* Stevenson, 10 Gray, 232; Anderson *v.* Speers, 21 Hun, 568. In Patterson *v.* Robinson, (1885) 36 Hun, 622, the court reasoned well to this conclusion, and cited as in harmony with their views Wiles *v.* Suydam, 64 N. Y. 173; Corning *v.* McCullogh, 1 N. Y. 47; Story *v.* Furman, 25 N. Y. 223, and Veeder *v.* Mudgett, 95 N. Y. 295. In Patterson *v.* Robinson, (1885) 37 Hun, 341, they said of their argument in the case *supra*: "We saw that this excess of indebtedness was due by the contract of the company, and, without regard to the statute, indeed wholly independent of the statute, to the creditors to whom the contract of the company made it due. We feel that no statute could deprive such creditor of his contract engagement with the company. Such being the contract relation between the company and such creditor, we thought that when the statute stepped in and added to the contract liability of the company for such excess of indebtedness the personal and individual liability of the trustees assenting thereto, it added it to the liability of the company where that liability was placed, namely, to the creditors to whom the company was liable for it. We saw no language in the statute at variance with such a construction, certainly none which seemed to imply that the liability of the assenting trustees for such excess of indebtedness should be diverted from the creditors to whom the company owed such excess, and be devoted to, or conferred upon, or shared among the creditors to whom the company did not owe it. And we had the more confidence in this construction, because of our opinion that section 23, unlike some other sections of the act, did not impose this personal liability as a penalty for wrong done or duty omitted, but as the terms upon which such excess of indebtedness might, with safety to the creditors, be permitted to the company."

[1] Laws N. Y. 1875, chap. 611.

[2] Torbett *v.* Eaton, (1888) 49 Hun, 209; s. c., 1 N. Y. Supp. 614.

[3] Patterson *v.* Robinson, (1885) 36 Hun, 622.

question was whether or not a director of a corporation organized under the statute[1] was liable for a debt of the corporation. Section 18 of that statute requires the filing of an annual report stating the amount of capital, the proportion actually paid in, etc., and provides that the report shall be signed "by the president and a majority of the directors, and shall be verified by oath of the president or secretary of such corporation and filed in the office of the secretary of state; and, if such corporation shall fail so to do, all the directors thereof shall be jointly and severally liable for all the debts of the corporation then existing, and for all that shall be contracted before such report shall be made." Section 21 declares that "if any certificate or report made, or public notice given, by an officer of any such corporation shall be false in any material representation, all the officers who have signed the same shall be jointly and severally liable for all the debts of the corporation contracted while they are officers thereof." A majority of the court held that a director was an "officer" within the meaning of this last section, and would be liable under it where he had signed a report which was false in a material representation.[2] A trustee not assenting to the creation of an indebtedness in excess of the capital stock of a corporation, his subsequent failure to dissent, when informed of the fact, would not be equivalent to the assent required by this statute.[3] In a case before the Supreme Court of New York, where it was not shown that either of two of the trustees of the corporation during the time in which there was incurred an indebtedness in excess of the capital stock of the corporation, ever attended any of the meetings of the trustees, or were consulted with reference

to the management of its business, or participated in its affairs, except to sign its annual reports, and then only upon their faith in the assertions of a co-trustee that they were correct, the court held that no such assent on their part was shown as was required to make them liable under the statute.[1] All the directors who are liable must be made parties to an action brought by a creditor of a corporation to enforce the individual liability imposed by the statute of New York upon the directors of a corporation by whom an indebtedness exceeding the amount of its capital stock is created, such liability being joint and not several.[2] In determining the amount of the liabilities of a corporation, to ascertain whether or not they exceed the amount of the capital stock, a judgment recovered against the corporation by one of its directors for money advanced by him to it, which judgment may have been subsequently assigned by him to a third person, cannot be treated as one of such liabilities.[3]

§ 249. Liability for incurring indebtedness in excess of capital stock — Illinois statute. In an action against directors of a corporation by the holder of notes of the corporation which had been issued under their directorate, based upon their liability for incurring such indebtedness in excess of the limit, as contended, imposed by the following section of the statute of Illinois, to wit: "If the indebtedness of any stock corporation shall exceed the amount of its capital stock, the directors and officers of such corporation assenting thereto shall be personally and individually liable for such excess to the creditors of such corporation," upon the question whether the facts stated in the bill brought the cause of action within the bar of the Statute of Limitations, the contention of the directors was that their liability, if any existed, was for a statutory penalty. The Supreme Court of Illinois held that the liability was not for a statutory penalty, and that the Statute of Limitations was not a bar to a recovery

[1] Ibid. As to what is a properly stated cause of action against directors under the statute of New York (Laws N. Y. 1875, chap. 611, § 22), which imposes a personal liability for an excess of indebtedness, in case the indebtedness of the corporation shall at any time exceed the amount of its capital stock, see Loveland *v.* Doran & Wright Co., (1891) 61 Hun, 619; s. c., 15 N. Y. Supp. 278.

[2] McClave *v.* Thompson, (1885) 36 Hun, 365.

[3] Ibid.; citing following: Robinson *v.* Thompson, 20 N. Y. Wkly. Dig. 557; Easterly *v.* Barber, 65 N. Y. 255; Knox *v.* Baldwin, 80 N. Y. 610.

by the creditors of these directors.[1] The same court, in a comparatively recent case have construed this statute, and said: "The liability is created only where the indebtedness of the corporation exceeds the amount of the capital stock, and is imposed only upon the directors and officers assenting to such excess of indebtedness. This plainly means assenting to its creation. Manifestly, a recognition of the indebtedness by the directors after it has been so contracted as to become binding upon the corporation, should not

[1] Woolverton *v.* Taylor, (1890) 132 Ill. 197. *Arguendo*, it was said: "In the absence of statutory prohibition it is not unlawful for the officers of a corporation to contract debts in excess of its capital stock. Unless restricted by statute, corporations, as individuals, may contract debts to the full extent of their credit, without reference to the amount of their capital stock. Neither is it, under all circumstances, bad management in a corporation to contract debts in excess of the amount of its capital stock. Its assets may be of such value as to give it credit, and warrant the incurring of liabilities far beyond that amount. While statutes in some states, by different forms of language, limit the right of such officers to contract indebtedness beyond prescribed limits, in others no restriction whatever has been enacted, and in many of those in which a limit is prescribed the indebtedness which may be contracted is not limited by the amount of capital stock, but may equal twice or three times that amount. If, therefore, such enactments are to be understood as indicating that it is deemed unwise to allow corporations to incur liabilities beyond a prescribed limit, it must be admitted that the sentiment is by no means harmonious as to where the limit should be placed. These statutes do not, therefore, indicate, as contended by counsel for appellees, that legislatures have considered it bad management in the affairs of a corporation to contract debts beyond the amount of its capital stock. [The quoted section] of our statute does not prohibit the contracting of indebtedness in excess of capital stock; neither does it in terms inflict a penalty for so doing. Therefore, a prohibition cannot be implied, and to say, as counsel insist should be done, that the assenting is made unlawful by the infliction of a penalty, is to assume the very question controverted. While it is true that statutes of other states making officers of corporations individually liable for contracting debts beyond a prescribed limit have been held to be penal, the language of those statutes will be found materially different from ours, and so far as we have been able to ascertain expressly prohibit the incurring of liabilities beyond certain limits fixed. In Hornor et al. *v.* Henning et al., 93 U. S. 228, the Supreme Court of the United States, in passing upon an act of congress regulating corporations in the District of Columbia, the language of which is almost identical with that of our statute, it was held that the act was not penal, for reasons which we think unanswerable. We followed that decision in Low *v.* Buchanan, 94 Ill. 76, in holding that the liability created by [our statute] could only be enforced in chancery, and this is, in effect, deciding that the action is not for the recovery of a penalty. 'It is a universal rule in equity never to enforce either a penalty or a forfeiture.' 2 Story's Eq. Jur. § 1319; Queenan *v.* Palmer, 117

have the effect of charging them with this statutory liability. After the indebtedness has been created by such agents and in such manner as to constitute it a valid obligation of the corporation, it becomes the duty of the directors to recognize its validity, and, so far as in their power, provide for its payment. * * * Such assent of [directors] could only be given by some affirmative voluntary act on their part, or at least some active participation or co-operation in the particular transaction out of which that indebtedness arose."[1] In a case where it was sought to enforce

Ill. 619. In Morawetz on Corporations (Vol. 2, § 908) it is said: 'It is not always quite clear what the courts mean to express by saying that statutes of this character are penal, and that they impose upon the directors a penal liability. The liability of directors under such a statute is undoubtedly not the result of a contract between the directors and the creditors of the corporation; but that is evidently not what the courts mean to express. The liability of directors to creditors for a tort, or a misapplication of corporate funds, or a breach of trust, does not arise out of contract; yet the courts would certainly not call this a penal liability, or refuse to enforce it because it arose under the laws of a foreign state. Nor is the liability of the directors under these statutes penal, in the sense in which the word penal is used in common law. It is not a penalty or fine imposed by the state for the infraction of public law. The liability of the directors is, both in form and substance, a private obligation, similar in many respects to that of sureties. It is imposed by the legislature partly for the purpose of inducing the directors to do their prescribed duties, and partly for the purpose of securing the company's creditors from losses caused by those who have control over the company's funds. The statutes imposing this liability establish a new rule of private right, a rule which, although unknown to the common law, may be founded on sound principles of justice and expediency.' In Neal *v.* Briggs, 12 Ga. 104, it is directly held that a provision in the charter of a corporation prohibiting the contracting of debts in excess of three times the amount of the capital stock paid in is not penal within the statute of that state limiting the bringing of penal actions to a period of six months."

[1] Lewis *v.* Montgomery, (1893) 145 Ill. 30; s. c., 33 N. E. Rep. 880. The court, in its opinion, recites the facts as to meetings of the board, the incurring of certain debts, etc., summing up with a statement that they found no evidence except that furnished by the record of the proceedings of the board, which tended "to charge the directors, with the exception of [one who managed the business], with any direct or personal agency in the incurring or contracting of the corporate indebtedness. Except so far as they acted officially at the meetings of the board they are not shown to have personally taken any part in the corporate business. It is not shown that they personally entered into any contracts, made any purchases, transacted any business or in any way interfered with the corporate dealings. The evidence is clear that [this managing director], during all the time the corporation was doing business, was in fact its general financial manager, and had complete and unquestioned control of its business affairs. Purchases and sales were

the statutory liability of directors and officers of a manufacturing corporation for the excess of indebtedness incurred beyond the capital stock of the corporation, it was held by the Supreme Court of Illinois that advances by a factor to a manufacturing corporation of a part of the invoice price of goods, under a contract that the former is to reimburse himself from the proceeds of the goods when sold, did not create any substantial liability or

made and indebtedness incurred by him at his discretion. The directors, having full confidence in him, and recognizing the preponderating influence to which the ownership of three-fourths of the stock of the corporation seemed to entitle him, allowed him to manage the business substantially as he pleased, and failed to keep themselves informed as to the financial situation. That in all this they were grossly recreant to their legal duties as directors and officers of the corporation goes without saying. But whether they thereby incurred the statutory liability for the debts of the corporation in excess of the amount of the capital stock presents quite another question. The provisions of the statute are as follows: 'If the indebtedness of any stock corporation shall exceed the amount of its capital stock the directors and officers of such corporation assenting thereto shall be personally and individually liable for such excess to the creditors of such corporation.' It should be observed that the statutory liability is not predicated upon the negligence of the directors or officers in the discharge of their official duties, but upon the fact of their having 'assented' to the indebtedness which constitutes the excess over the amount of the capital stock. The contention of the complainants seems to be that as the board of directors is the governing body of the corporation, their constituting [one of their number] its general financial agent, either by appointment or by sufferance, made him their agent so as to warrant an application to them of the maxim *respondeat superior*, and to make his acts and assent the acts and assent of the directors. This position is clearly untenable. The directors, though the governing body of the corporation, are only its officers and agents, and any subordinate agent appointed by them or acting by virtue of their sufferance or recognition, does not thereby become their agent but the agent of the corporation. His acts are the acts of the corporation so as to make it liable for debts or obligations incurred by him on its behalf, but they are not the acts of the directors unless commanded or authorized by them. The fact that the directors might have interfered to prevent [this manager] from running the corporation in debt beyond the amount of its capital stock, or that they failed in other respects to perform their appropriate functions, may be charged against them as negligence, but it fails to establish their assent to the indebtedness thus contracted. In Woolverton *v.* Taylor, 132 Ill. 197, the statute sought to be invoked here was under consideration, and we there held that while the liability imposed is not penal but contractual, it is like that of a surety, and, therefore, *stricti juris*. This being the case, the statute should receive a construction in consonance with the nature of the obligation imposed. The words employed should be interpreted according to their plain and obvious meaning, and should not be extended by construction so as to embrace cases not clearly within the terms of the statute. The liability is

indebtedness against the corporation while the goods are in the hands of the factor and before their order, within the meaning of the statute of Illinois relating to such liability of directors and officers of corporations; also, that the fixing of the salary of the superintendent of the corporation and that of the secretary, in the absence of other proof, was not sufficient to show that any corporate debt was thereby incurred, as it would be presumed that such salaries were paid as they accrued. Further, it was held that to show the incurring of an indebtedness of a corporation in excess of its capital stock, it was not sufficient to show that various expenditures were ordered or authorized by the board of directors, when, so far as it appeared, such expenditures may have been met at the time by cash payments. It must be shown that such expenditures resulted in indebtedness, or formed part of the indebtedness in excess of the capital stock.[1]

§ 250. United States Supreme Court decision on a similar statute — the proper action in such a case.— An action at law was brought by a creditor of a savings bank in the District of Columbia against the trustees of the bank upon a liability as alleged incurred by a violation of the following section of the act of congress under which it was organized, to wit: "If the indebtedness of any company organized under this act shall at any time exceed the amount of its capital stock, the trustees of such company assenting thereto shall be personally and individually liable for such excess to the creditors of the company." The Supreme Court of the United States affirmed the sustaining of a demurrer by the lower court to this action, holding that an action at law could not be sustained by one creditor among many for the liability thus created, or for any part of it, but that the remedy is in equity.[2]

created only where the indebtedness of the corporation exceeds the amount of the capital stock, and is imposed only upon the directors and officers assenting to such excess of indebtedness. This plainly means assenting to its creation. Manifestly, a recognition of the indebtedness by the directors after it has been so contracted as to become binding upon the corporation, should not have the effect of charging them with this statutory liability. After the indebtedness has been created by such agents, and in such manner as to constitute it a valid obligation of the corporation, it becomes the duty of the directors to recognize its validity, and, so far as is in their power, provide for its payment."

[1] Lewis *v.* Montgomery, (1893) 145 Ill. 30.

[2] Hornor *v.* Henning, (1876) 93 U. S. 228. Mr. Justice MILLER, speaking for the court, said: "We are of opinion

§ 251. New York statute — liability for false statements in certificates, etc., filed.— It is entirely immaterial whether the creditor of the corporation relies upon the certificate filed by the officers or not. As long as the trustee knows the certificate to be false, and the debt is thereafter contracted while he is an officer of the company, it comes within the provisions of the statute making the trustees liable on account of the false statement in the certificate.[1] The plaintiff in such actions must establish that the certificate filed was in point of fact false, and that the trustees signed it with knowledge of its falsity.[2] Renewal notes given after the filing by the officers of a corporation of a false certificate that all of its capital stock had been paid in for a debt contracted by the corporation before the filing of the certificate is a "debt" within the meaning of the statute making directors and officers liable for the debts of the corporation.[3] A director cannot defend an action to make him liable for signing an annual report false in any material particular upon the ground that he was also a creditor of the corporation.[4] The constitutionality of

that the fair and reasonable construction of the act is that the trustees who assent to an increase of the indebtedness of the corporation beyond its capital stock are to be held guilty of a violation of their trust; that congress intended that so far as this excess of indebtedness over capital stock was necessary, they should make good the debts of the creditors who had been the sufferers by their breach of trust; that this liability constitutes a fund for the benefit of all the creditors who are entitled to share in it, in proportion to the amount of their debts, so far as it may be necessary to pay their debts. The remedy for this violation of duty as trustees is in its nature appropriate to a court of chancery. The powers and instrumentalities of that court enable it to ascertain the excess of the indebtedness over the capital stock, the amount of this which each trustee may have assented to, and the extent to which the funds of the corporation may be resorted to for the payment of the debts; also the number and names of the creditors, the amount of their several debts, to determine the sum to be recovered of the trustees and apportioned among the creditors in a manner which the trial by jury and the rigid rules of common-law proceedings render impossible. This course avoids the injustice of many suits against defendants for the same liability, and the greater injustice of permitting one creditor to absorb all or a very unequal portion of the sum for which the trustees are liable, and it adjusts the rights of all concerned on the equitable principles which lie at the foundation of the statute."

[1] Ferguson *v.* Gill, (1892) 64 Hun, 284; s. c., 19 N. Y. Supp. 149.

[2] Ibid.

[3] Ibid.

[4] Richards *v.* Crocker, (N. Y. City Court, Spl. T. 1887) 19 Abb. N. C. 73. Judge RAPALLO in Pier *v.* Hanmore, 86 N. Y. 101, says of the purpose of this statute: "The purpose for which the annual reports are re-

the New York statute has been sustained by the Court of Appeals.[1] In actions against directors under this statute it is not necessary to show knowledge on the part of the officer at the time of signing; proof that the writing is untrue "in any material representation" would be sufficient.[2] The rule governing the action of a jury in such a case is that they are not required to give the defendants the benefit of any reasonable doubt in the

quired to be published is that the public may be correctly informed of the financial condition and resources of their companies in order that they may judge of the credit to which they are entitled." In Walton *v.* Godwin, 58 Hun, 91, Mr. Justice DANIELS used this language: "The report has evidently been required as information to the public concerning the financial condition and responsibility of the corporation. This information is intended as a security to persons dealing with the company. And whatever would materially affect their judgment in their dealings should be regarded as a material representation in the report itself. But if a report proves to be untruthful in representations which would have no effect whatever upon the judgment or conduct of persons dealing with the corporation, such representations could not be consistently held to be material. And it must be by this criterion that the question of the liability of the persons signing the report should be determined, for if it contains untruthful statements and those statements appear to be so entirely unimportant that they would not affect, in the least degree, the credit of the company or the conduct of persons dealing with it, then they cannot legally be held to be material misrepresentations." After quoting the above in Torbett *v.* Godwin, (1891) 62 Hun, 407, 411; s. c., 17 N. Y. Supp. 46; 27 Abb. N. C. 444, BARRETT, J., as to the construction to be given to the section imposing liability upon officers for certificates, etc., "false in any material representation," has said: "The construction * * * should, if possible, be in harmony with its object and purpose as thus defined. That will be accomplished by confining the liability to cases where credit may *possibly* have been given to the corporation upon the faith of the report. In other words, to debts contracted after it is filed. This gives force also to the word 'representations' as used in the section. That section does not read false in any material 'statement' or material 'fact,' but false in any material 'representation.' Representation implies an object addressed. Representations to whom, then? Plainly to any one who contemplates trusting the company thereafter. And this view is reinforced by the fact that the false representation which creates liability is not limited by the section to a certificate or report, but may be embodied in any *public notice* given by the officers of the company. Shall it be said then that for any negligent or inadvertent publication the officers of the company are to be mulcted, not only for the possible consequences of such publication, but for debts contracted before it was thought of?" The reversal of the judgment against the directors on this case negatives this query.

[1] Huntington *v.* Attrill, (1890) 118 N. Y. 365; s. c., 23 N. E. Rep. 544.

[2] Ibid.

sense applicable to criminals. They may be governed in reaching a satisfactory result by the fair preponderance of evidence.[1] The false representation alleged in this case was that the directors had represented in their report that the whole capital stock, $700,000, had been paid in. The whole stock was issued to one individual, one of the defendants here, for a tract of land upon the seashore. It became necessary, therefore, in the progress of the case for the jury to consider what was the "fair value" of this property when considered in connection with the provision of the statute which prohibits the issuing of stock of a corporation organized under it except for "property actually received for the use and legitimate purpose of said corporation at its fair value." "Fair value" in this connection the Court of Appeals of New York held to be that which the property had at the time of sale; that it was not dependent upon the subsequent success or failure of the investment, further than that result may have been legitimately within evidential contemplation at the time of the sale in view of the uses for which it may have had available advantages within itself.[2] As bearing upon the real value of this property for which the stock was issued to so large an amount it was held not to have been error to allow the plaintiff to prove on the question of value that the land purchased, with extensive improvements thereon, was afterwards sold at judicial sale for $175,000.[3] In an action of another creditor against these same defendants upon their liability under the statute for having made a false statement in their certificate which they had filed, the Court of Appeals sustained the action of the trial judge in refusing to accept a verdict of the jury for an amount less than the whole amount of his debt and directing a verdict for the latter amount on the ground that having found that the plaintiff was entitled to a recovery, that being a matter of fact for the jury, the measure of damages was the amount of the debt and this he was entitled to recover.[4] Where the liability of a trustee or director under the statute for making a false certificate has reference to an overvaluation of property taken by the corporation from its stockholders, the statute would not be violated in respect to the issuing of stock in payment for property unless such persons in bad faith

[1] Ibid.

[2] Ibid.

[3] Ibid.

[4] Hatch *v.* Attrill, (1890) 118 N. Y. 383; s. c., 23 N. E. Rep. 549.

put a fictitious value upon their property for the purpose of evading the statute and defrauding others. If done, and the trustee knew of it, he would be liable.[1] The rule that to sustain an action for fraud founded upon representations made by one charged with fraud, it must be made to appear that he believed, or had reason to believe, at the time he made them, that the representations were false, or that, without knowledge, he assumed or intended to convey the impression that he had actual knowledge of their truth, and that the injured party relied upon them to his injury, is applicable to the case of representations made by a director of a corporation, in the form of published statements and reports, as to its financial condition. Knowledge of all the affairs of the corporation cannot be imputed to him for the purpose of charging him with fraud.[2] In a case brought by one who alleged that he had been led to loan a large sum of money to a corporation by the false and fraudulent representations of its trustees as to its capital stock having been paid in, etc., in a report, there was a judgment against all the trustees. On the appeal it was held by the court that the facts that the name of one of these defendants was published as a trustee of the corporation and that a certificate of stock was issued to him were not sufficient to authorize a verdict against him for the fraud perpetrated by other trustees and agents of the corporation.[3] The mere fact of being a director and stockholder is not sufficient *per se* to hold one so situated liable for the frauds and misrepresentations of the active managers of a corporation. They are the agents of the corporation, not of the directors, as individuals, and have no power to bind the latter by their statements. Some knowledge and participation in the act claimed to be fraudulent must be brought home to the person charged. It is only where a director lends his name and influence to promote a fraud upon the community, or is guilty of some violation of law or other mismanagement that he is personally liable.[4]

§ 252. Illustrations.— A statement in such a report that certain persons are stockholders in the corporation, and that the

[1] Van Vleet *v.* Jones, (1894) 75 Hun, 340; s. c., 26 N. Y. Supp. 1086.

[2] Wakeman *v.* Dalley, (1872) 51 N. Y. 27; s. c., 10 Am. Rep. 551, affirming 44 Barb. 498.

[3] Arthur *v.* Griswold, (1874) 55 N. Y. 400.

[4] Ibid.

amount of their stock has been already paid, when in fact such persons are not stockholders at all, would be "false in a material representation."[1] That defendant signed such report in good faith under the advice of counsel, and that he believed the statement made in it to be true would be no defense against his statutory liability under this statute.[2] It appeared in a New York case that one who was named in the annual report made by the corporation under the requirements of the statute as one of the stockholders was not and never had been the owner of stock in the corporation; that a certificate for ten shares of stock, amounting to the sum of $1,000. had been sent to him, which he had refused to accept and had returned, and that this amount, as well as an additional sum of $1,000, for which there was no foundation whatever, was included in the amount of the capital stock of the corporation stated in the report to have been paid in. The other stock paid in was stated at $148,600. The Supreme Court in General Term held that, in view of the fact that the jury might have found that $146,600 of the capital stock of the corporation had been paid in, this error to the extent only of $2.000 did not make the report "false in any material representation."[3] In a case before the New York Court of Appeals, brought by a creditor against a trustee of a corporation to enforce the liability of the latter under the New York statutes for making a statement in the annual report that the capital stock of $2,000,000 had been paid up in full, on the ground that the statement was false to the knowledge of the signers, it appeared that the stock of the corporation was issued to one, in payment for certain iron mining property, then undeveloped, which property he had purchased of a corporation of which the trustee sued was a stockholder, and the latter received from him $10,000 of the stock of the new corporation to enable him to act as trustee. The vendor of the property sold to the corporation surrendered to the new corporation 1,000 shares of the stock, which was pledged, with

[1] Brandt *v.* Godwin, (City Court N. Y., Spl. Term, 1889) 3 N. Y. Supp. 807.

[2] Ibid.

[3] Walton *v.* Godwin, (1890) 58 Hun, 87; s. c., 12 N. Y. Supp. 436. DANIELS, J., said: "This slight discrepancy or difference in so large an amount would have no effect whatever upon the transactions or dealings of creditors with the corporation And for that reason these statements could not be assumed to be, as they appear to have been in the charge of the court, materially false statements rendering the officers who signed the report liable for its debts."

$70,000 of the bonds of the corporation, to secure a loan of $35,000, and gave 500 shares of the stock as a commission to the officer who negotiated the loan. The property which was sold by this vendor to the new corporation for $1,000,000 of the stock of the new corporation and $200,000 of its bonds, and the consideration for which was expressed in his deed to the new corpotion as $600,000, proved to be worth not over $60,000. The trustee sued had knowledge, it was shown, of all these facts. The Court of Appeals held that the facts justified a finding that this trustee signed the report in bad faith, knowing it to be false.[1] In an action against trustees of a manufacturing corporation to enforce the liability imposed by the statutes of New York[2] for making a false report, where the falsity alleged was solely in the statement that the capital stock had been paid in full, without stating that all or a portion of it was paid for in property as required by a later statute,[3] the New York Court of Appeals declared this rule to be applicable, to wit: To charge the officer with the severe penalty imposed for signing a false report, knowing it to be false, some fact or circumstance must be shown indicating that it was made in bad faith, willfully, or for some fraudulent purpose, and not ignorantly or inadvertently, and this is a question of fact which must be passed upon before the liability can be adjudged.[4] Finch, J., further said: "But the necessity of such proof of a willful and fraudulent purpose we confined to a case where the sole falsity of the report originated in our construction of its import, as meaning a payment in cash, although not so stated in express terms, and where, as a consequence, it was possible for the officer to have signed what we construe to be a falsehood, but what, as he understood it, might have been a truth. In such case it is just to require that some evidence of bad faith, something indicating a consciousness of falsehood instead of belief of truth should be given. In other words, the penalty follows an actual and not a constructive falsehood; one known and understood to be such and possibly believed to be otherwise."[5] The trustees of a manufacturing corporation

[1] Blake *v.* Griswold, (1886) 103 N. Y. 429. The court distinguished Lake Superior Iron Co. *v.* Drexel, (1892) 90 N. Y. 87.

[2] N. Y. Laws 1848, chap. 40, § 15.

[3] N. Y. Laws 1853, chap. 333.

[4] Bonnell *v.* Griswold, (1882) 89 N. Y. 122; rule declared in Pier *v.* Hanmore, 80 N. Y. 128.

[5] Ibid., in which it was held that where the stock of the corporation was actually paid in in cash, the mere fact that the corporation bought out assets of an old company at their fair value did not call for or authorize a statement in the report that the stock had been paid for in property. See, also, Wickens *v.* Foster, (1885) 22 N. Y. Wkly. Dig. 426.

would not incur the liability imposed upon them by the statutes of New York[1] for signing an annual report "false in any material representation," simply by omitting from the aggregate indebtedness of the corporation certain liabilities of the corporation, although they may have known of it at the time the report was made.[2] The liability of a director of a corporation formed under the New York statute[3] by reason of making a false report abates on the death of the original creditor of the corporation, and cannot be revived in favor of or prosecuted by his personal representatives.[4] The Maryland Court of Appeals, two justices, however, dissenting, has held that the liability imposed upon directors or officers by the New York statute on account of false statements in reports, etc., required of them as to any material representation was a penalty and not enforceable in the state of Maryland; and that if a judgment had been obtained in New York under the statute, no action could be maintained on the judgment in the state of Maryland.[5] The officers of a corporation organized in pursuance of a plan of a syndicate for whom property had been purchased for $150,000, with a view to sell the same to this corporation, certified that stock of the value of $1,500,000 had been issued to the amount of the value of the property purchased of the syndicate for the purpose of the corporation. These officers were held liable to persons who had advanced money to the corporation under the statute of New York, which provides that "if any certificate or report made, or public notice given, by the officers of any such company, in pursuance of the provisions of this act, shall be false in any material representation, all the officers who shall have signed the same, knowing it to be false, shall be jointly and severally liable for all the debts of the company contracted while they are stockholders or officers thereof." The statement in the

[1] N. Y. Laws 1848, chap. 40, § 15.

[2] Butler *v.* Smalley, (1885) 101 N. Y. 71.

[3] Laws N. Y. 1875, chap. 611.

[4] Boyle *v.* Thurber, (1888) 50 Hun, 259; following Brackett *v.* Griswold, 103 N. Y. 425.

[5] Attrill *v.* Huntington, (1889) 70 Md. 191; s. c., 16 Atl. Rep. 651; citing, in support of the holding, Flash *v.* Conn, 109 U. S. 376; Wisconsin *v.* Pelican Insurance Co., 127 U. S. 290.

certificate as to the stock was held to be a false one within the letter and the spirit of the statute.[1]

§ 253. Statutory liability — Rhode Island statutes. — The statutes of Rhode Island providing that if certain certificates are not filed, certain officers of corporations shall be liable for "all debts of the company contracted," has been construed by the Supreme Court of that state, and they have held that the words "debts contracted" did not include torts of the corporation, nor judgments against the corporation founded on such torts.[2] So, all the other statutes which provide that, if the debts of a corporation exceed its paid-in capital, the directors under whom the excess occurs shall be liable jointly and severally to the extent of the excess, "for all the debts of the company then existing, and for all that shall be contracted as long as they shall respectively continue in office," and until the excess shall disappear, have also been construed, and the directors held not to be liable for torts of the corporation committed pending the excess, nor for judgments against the corporation founded on such torts.[3]

§ 254. Statutory liability — various states. — The statutes of Indiana provided, as to such corporations as the one involved

[1] Chittenden *v.* Thannhauser, (1891) 47 Fed. Rep. 410.

[2] Pub. St. R. I. 1882, chap. 155, §§ 2, 3, 4.

[3] Pub. St. R. I. 1882, chap. 155, § 15; Leighton *v.* Campbell, (1890) 17 R. I. 51; s. c., 20 Atl. Rep. 14. The court said: "The plaintiff cites in support of this contention Mill Dam Foundery *v.* Hovey, 21 Pick. 417, 455, and Carver *v.* Braintree Manufacturing Company, 2 Story, 432. These cases relate to the liabilities of corporations under a Massachusetts statute subjecting them to individual liability for the 'debts and contracts' of the corporation, or for the 'debts contracted' by it, and not to the liability of officers of corporations under other provisions. In the first case it was held that the phrase covered a claim for unliquidated damages arising *ex contractu*. In the second it was held that the phrase 'debts contracted,' being broadly construed, covered a liability incurred by the infringement of a patent, or, in other words, a liability for tort. Judge STORY, in giving this construction, relied somewhat on the authority of Mill Dam Foundery *v.* Hovey, but still more on his view that the provision imposing the liability was to be regarded as remedial, and was, therefore, to be liberally construed, in fact virtually conceding that, in any other view, the construction would be too broad. In Child *v.* Boston & Fairhaven Iron Works, 137 Mass. 516, the court say, in criticism of Carver *v.* Braintree Manufacturing Company: 'There are no cases decided by the courts of the commonwealth in which a stockholder has been held liable for a tort of the corporation, and other decisions of Mr. Justice STORY stand unsupported by any direct authority, either before or since.' There are cases of other states in which it has been held that the words 'debts contracted' do not subject the corporators to liability for the torts of the corporation. Heacock *v.* Sherman, 14 Wend. 58; Bohn *v.* Brown, 33 Mich. 257; Cable *v.* McCune, 26 Mo. 371. In the case at bar, however, the question relates not to the corporators, but to officers, under provisions relating to them exclusively as such, imposing duties on them, and making them liable in case they reject or refuse to perform them. These provisions, as contradistinguished from the provisions in regard to corporations, are deemed to be penal, and for that reason to be strictly construed. Chase *v.* Curtis, 113 U. S. 452. We do not think that any court would hold that the words 'debts contracted,' if strictly construed, would cover unliquidated claims for damages arising *ex delicto*. Child *v.* Boston & Fairhaven Iron Works, [137 Mass. 516]." As to the contention that the claim had been reduced to judgment, and thus become a debt of the corporation, it was said: "The New York cases, under statutory provisions similar to ours, hold that, in that state, the trustees of corporations are liable, if at all, only on the original claim, and that a judgment against the corporation thereon has no effect as against them. Miller *v.* White, 50 N. Y. 137; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; Esmond *v.* Bullard, 16 Hun, 65. It has been held in other states that the reduction of a claim for damages against a corporation arising *ex delicto* to a judgment does not change its character as against the delinquent officers, so as to charge them thereon as for a debt contracted by the corporation. Cable *v.* Gaty, 34 Mo. 573; Bohn *v.* Brown, 33 Mich. 257; so, also, by the Supreme Court of the United States, Chase *v.* Curtis, 113 U. S. 452;" citing, also, Whitaker *v.* Masterton, 106 N. Y. 277, 280, upon some points.

[1] Clow *v.* Brown, (1892) 134 Ind. 287; s. c., 33 N. E. Rep. 1126.

in a case before the Supreme Court of that state, as follows: "The capital stock, as fixed by such company, shall be paid into the treasury thereof within eighteen months from the incorporation of the same." "If any company organized and established under the authority of this act, and of the act to which this is supplementary, shall violate any of the provisions thereof, and shall thereby become insolvent, the directors ordering or assenting to such violation shall jointly and severally be liable in an action founded on said acts, for all debts contracted after such violation as aforesaid." It was ruled in the case that if the directors, or any number of them, refused to enforce, on behalf of the company, the duty of the company to collect the stock, such refusal was an assent on their part to a violation of the company's duty, and it was immaterial whether the plaintiff sued all or a majority of the directors.[1] A protest, not in writing, by a director of a gravel road company, before the board against the contracting of debts in excess of its solvent stock, will absolve

him from liability on account of such contracting of debt.[1] In an action to enforce such a liability of directors, it must be averred and proved that the directors against whom the action is brought contracted the debt, and that the debt, when contracted, exceeded the solvent stock of the company.[2] The failure of a majority of the directors of a corporation to file the reports, as required by the law of Michigan, will be presumed intentional, and will render each director liable for the debts of the corporation under the statute which renders the directors of corporations liable if they "intentionally neglect or refuse to comply" with its provisions.[3] The Montana Supreme Court has held that the statute of that state imposing an individual liability upon the trustees of a corporation for not filing the annual report of the corporation's condition required by the statute could not be construed so as to excuse the trustees from liability for debts contracted prior to a default in the matter of filing the report. Therefore, they held that the facts stated in defense to an action to enforce such statutory liability that before the time for filing such annual report the corporation was insolvent and had entirely abandoned its business; that all the property of the corporation belonged to one of its trustees, having been delivered to him in satisfaction of an indebtedness, and that for a period of two months no officer or trustee had exercised any corporate act or function, and that there was no intention to resume the business of the corporation, did not dissolve the corporation and constituted no defense to the action.[4] Officers of a corporation certifying that the capital

[1] Schofield v. Henderson, (1879) 67 Ind. 258.

[2] Aimen v. Hardin, (1877) 60 Ind. 119.

[3] Van Etten v. Eaton, 19 Mich. 187. As to the construction of the statute referred to, see Breitung v. Lindauer, 37 Mich. 217. As to what are "debts" within the meaning of this statute, the Supreme Court of Michigan has said, in Lockhart v. Van Alstyne, 31 Mich. 76, 78: "Liabilities of a company which may give cause of action against it and result in judgments are not within the statute unless they constitute present debts. A debt is that which one person is bound to pay another, either presently or at some future period; something which might be the subject of a suit as a debt, and not something to which the party may be entitled as damages in consequence of a failure to perform a duty or keep an engagement. A right to a dividend from the profits of a corporation is no debt until the dividend is declared. Until that time, the dividend is as something that may possibly come into existence, but the obligation on the part of the corporation to declare it cannot be treated as the dividend itself."

[4] Gans v. Switzer, (1890) 9 Mont. 408; s. c., 24 Pac. Rep. 18.

stock of the company is paid in, when in fact it is paid in property of an uncertain value, will be liable under the New Jersey statute making them liable for the debts of the corporation in case they falsely certify that the capital stock has been paid in.[1] The statute of Vermont making the directors of a private corporation liable for all "debts contracted" before the publication of its articles of association, has been held not to embrace all contracts entered into by the corporation before such publication, but only "debts" so contracted; it would not embrace damages for the non-performance of a special contract.[2] The assenting by a director of a corporation to the execution of new notes for former notes held by the corporation, where the original indebtedness was not increased thereby, it being only the substitution of one set of notes for the other, it has been held did not fall within the statute of Vermont which prohibited the contracting of debts to an amount greater than three-fourths of the capital stock paid in, and making any director assenting thereto liable for the excess to the creditors of the corporation.[3] A statute of Vermont (R. L. Vt. § 3279) provides that in case debts are contracted by a corporation for voluntary association before compliance with the provisions of the preceding section (3278), the president and directors shall be personally liable for such debts. The Supreme Court of that state said: "It is clear that the conditions precedent to the creation of a liability under that section are, first, the existence of a corporation, recognized as such by the laws of this state; second, the contracting of a debt by such corporation, and, third, a failure to comply with the provisions of section 3278 before the contraction of such debt." They held that where articles of association, under chapter 153, Revised Laws of Vermont, are signed upon the understanding that they shall not take effect until the happening of a certain contingency, they do not become effective, and no corporation exists until that contingency happens; in such case a director, who is guilty of no act or omission by which the party extending the credit is misled, would not be liable; but where the defendant represented to the plaintiff that such corporation had been legally organized, and that he was a director, he was held to be estopped from making this defense

[1] Waters v. Quimby, 3 Dutch. (N. J.) 198; affirmed in 4 Dutch. 533.

[2] Cady v. Sanford, 53 Vt. 632.

[3] National Bank v. Paige, 53 Vt. 452.

and to be liable under the statute.[1] "Debts contracted" for which negligent officers of corporations, under Connecticut statutes, may be held liable, must be debts of the corporation in favor of some one who gave it credit.[2] The Code of Virginia makes those of the directors of a corporation, who declare a dividend of net profits, when the corporation is insolvent, who concur in the act in their individual capacity, jointly and severally liable to the creditors of the corporation for the amount of the capital stock so divided. In an action to enforce the personal liability under this statute, the question of the insolvency of the corporation when the dividend may have been declared is a question of fact, and the insolvency of the corporation must be established by proof to justify a recovery from the directors individually.[3] The United States Supreme Court has held that the remedy in the courts of the United States to enforce the personal liability of directors for permitting the corporation to contract debts in excess of the capital stock, under the statutes of a state, is by bill in equity.[4]

§ 255. Liability of directors or officers under an English statute.— An English statute provided that if it appears, in the course of winding up any company, "that any past director, manager, official or other liquidator, or any officer of such company, has misapplied or retained in his own hands, or become liable or accountable for any moneys of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may * * * examine into the conduct of such director, manager or other officer, and compel him to repay any moneys so misapplied or retained, or for which he has become liable or accountable, together with interest, after such rate as the court thinks just, or to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance or breach of trust as the court thinks just." This statute has been construed by the Court of Appeal with this result: The remedy afforded by this statute is only for the recovery of damages for losses incurred. The misfeasance to which it is directed is not restricted to acts of commission, but extends to all breaches of trust in relation to a company, through which loss is incurred. Misfeasance is not to be imputed to a director unless he has dishonestly acted or abstained from acting in conflict with his plain duty, and the burden of proof lies on the party making the charge, but in considering the question of the director's liability, there must be imputed to him a special knowledge of the business which he has undertaken. The Court of Appeal held that directors were liable for losses occasioned through acts done by them as directors in matters which are *ultra vires* the company, and that their liability was not dependent upon any question of honesty of intention.[1] In a very recent case involving the liability of directors of a company under this statute or a later one replacing it, the directors were held liable to repay an amount of money which they had invested, of the company's, in shares of a building securities company, which investment was *ultra vires* on the part of the company they represented. It appeared, also, in this case that two of the directors were not present at the meeting when the investment was ordered, but they were present at the next meeting at which the minutes of the previous meeting were read and confirmed. One of them was in the chair and signed the minutes. He was, also, in the chair at the next general meeting of the company, and then

[1] Corey *v.* Morrill, (1889) 61 Vt. 598; s. c., 17 Atl. Rep. 840.

[2] Armstrong *v.* Cowles, 44 Conn. 48; Gen. St. Conn. 314, § 3.

[3] Slaymaker's Admr. *v.* Jaffray & Co., (1886) 82 Va. 346.

[4] Stone *v.* Chisolm, (1885) 113 U. S. 302; s. c., 5 Sup. Ct. Rep. 497, a case brought under the statute of South Carolina. It was said by the court: "The conditions of the personal liability of the directors of the corporation, expressed in the statute, are that there shall be debts of the corporation in excess of the capital stock actually paid in, to which the directors sought to be charged shall have assented, and this liability is for the entire excess both to the creditors and to the corporation. To ascertain the existence of the liability in a given case requires an account to be taken of the amount of the corporate indebtedness, and of the amount of the capital stock actually paid in; facts which the directors, upon whom the liability is imposed, have a right to have determined, once for all, in a proceeding which shall conclude all who have an adverse interest, and a right to participate in the benefit to result from enforcing the liability. Otherwise, the facts which constitute the basis of liability might be determined differently by juries in several actions, by which some creditors might obtain satisfaction and others be defeated. The evident intention of the provision is that the liability shall be for the common benefit of all entitled to enforce it according to their interest or apportionment, which, in case there cannot be a satisfaction for all, can only be made in a single proceeding to which all interested can be made parties." Adhering to and reaffirming Hornor *v.* Henning, 93 U. S. 228.

[1] In re The Liverpool Household Stores Association (Limited), (1890) 59 L. J. R. (N. S.) Ch. Div. 616.

referred to this investment, and, speaking in behalf of the directors, said: "We carefully considered the matter and deemed it advisable to exercise our right of subscription, and have no reason to regret our decision." The Court of Appeal held that although the presence of these two directors at the meeting at which the minutes of the previous meeting were confirmed was not sufficient, in itself, to make either of them liable for the *ultra vires* investment, yet the one presiding had, by his action as chairman at that meeting, and by his statement at the general meeting of the company, shown that he took an active part in the investment and would be held responsible for it.[1] It was held that as to one *ultra vires* investment these directors, being considered in these matters of liability, by the courts, in the light of trustees, were entitled to the benefit of the English Statute of Limitations with reference to trustees.[2] A director in this English case held shares of a company not fully paid up, and his directors' fees were unpaid. On a day when the company's balance at its bankers was two pounds, eleven pence, he gave to the company a cheque for seventy pounds, the amount remaining unpaid on his shares, and received at the same time from the company a cheque for a like amount, on account of his fees, signed by himself and another director. Within three months there were proceedings for winding up the company. The Court of Appeal held that the payment to the director was a preference which, by the terms of the statute, should be deemed to be fraudulent, and that all the directors who concurred in making the payments were guilty of a misfeasance, and that they should be ordered, jointly and severally, to repay the amounts.[3] In another case of a winding up of an English company, it appeared that two persons who were working a quarry in partnership, one of them owning an adjoining quarry and having an option of a lease of a third, wishing to form a company for working them, called in two other persons for the purpose, and the four entered into an agreement with a trustee for the intended company to sell to the company the quarries, to be paid partly in cash and partly in paid-up shares, the two who were called in to receive 120 shares each. The company was formed. One of the latter two persons

[1] In re Lands Allotment Co., Law Rep. (1894), 1 Ch. 616.
[2] Ibid.
[3] In re Washington Diamond Mining Co., Law Rep. (1893), 3 Ch. 95.

was one of the first directors. The agreement between the four and the trustee of the company was confirmed and these two received their paid-up shares. It developed, upon the winding up of the company, that these parties called in had no interest in the property sold to the company, except their interest as lessees of the third quarry, which lease was of even date with the agreement to sell to this company, and the director of the company admitted that he had no interest in this latter, until that day, and had nothing to do with fixing the price. The articles of the company provided that the agreement for sale should not be impeached on the ground of the directors, or any of them, being vendors or promoters of the company, nor should they be accountable for benefits secured to them. The trial justice held that this director was liable to contribute to the assets of the company a sum equal to the nominal amount of the shares issued to him and to the other party, on the ground of his misfeasance as a director in accepting the shares allotted to himself, and in allowing the shares of the other party to be issued to him. The Court of Appeal held, affirming the decision of the trial justice, that, although if these parties had been *bona fide* owners of shares in the leased quarry, and had agreed to sell their interests for shares in the company, the transaction could not have been impeached, the insertion of their names as vendors, when they had no real interest in the property sold, was a device for enabling them to get fully paid-up shares for their services in the promotion of the company, and that the issuing of those shares was a misfeasance on the part of the directors, and that, as it was not known to the company that these parties were not really vendors, the clause in the articles was no protection to the director.[1] In another English case it appeared that the directors of a company having power to lend money and to promote other companies, passed a resolution that a cheque for £250 should be drawn in favor of a third party, for a loan to him of that amount, on certain security. The cheque was drawn and handed to the solicitor of the company, who gave it to the payee without receiving the security. The directors passed a second resolution that a cheque for £1,000 should be drawn in favor of the same party for a loan to him of that amount on security of (*inter alia*), a contract, the date of which and the names of the parties to which, were left in blank

[1] In re Westmoreland Green & Blue Slate Co., Law Rep. (1893), 2 Ch. 612.

in the resolution. This cheque was, also, drawn and handed to the solicitor of the company, who gave it to the payee without obtaining the security. The directors knew the nature of the contract, and that it related to a company which the payee of the cheque was bringing out, and the existence of which the directors believed to be for the benefit of their own company, and they advanced the £1,000 to assist him in bringing out the new company. The company afterwards sued this party for the amount of the loans, recovered judgment against him, but never realized anything on the judgment. In the winding up proceedings of the company, it becoming insolvent, the liquidator, under the English statutes, sought to charge the directors with the sums loaned. VAUGHAN WILLIAMS, Justice, held that the directors, having exercised judgment and discretion, were not liable for misfeasance or breach of trust in relation to the company.[1] One who was requested by the promoter of a projected company to become a director, agreed to do so upon the terms that, if he should at any time desire to part with the shares which he was to take in order to qualify him as director, the promoter should purchase them from him at the price he should pay for them. The company was subsequently formed and he became a director, took the qualification shares, and paid for them at par out of his own money, and from time to time acted as director, but he never disclosed to his co-directors or to the company, the existence of his agreement with the promoter. He afterwards resigned his office as director, and subsequently to his resignation, the promoter, at his request, paid to him the sum which he paid for the shares, and accepted a transfer of them. At this time the shares were valueless in the market. The English Court of

[1] In re New Mashonaland Exploration Co., Law Rep. (1892), 3 Ch. 577. Referring to the statute, section 10 (Winding Up) Act, 1890, the justice said: "It has been said that you cannot bring directors within the section, unless they have been guilty of a misfeasance in the nature of a breach of trust; but, be that as it may, it is plain that if directors are guilty of such negligence that it cannot be said that in doing what they did they attempted to perform their duty as directors, then such directors are guilty of misfeasance To use [counsel's] words, if the directors did not *bona fide* exercise their discretion and judgment as agents of the company, that is misfeasance within the meaning of the section. I shall adopt that construction with the exception of the words *bona fide*, and hold that, in order to make the directors liable, you must be able to deny that they did really exercise their judgment and discretion in this way."

Appeal, in a proceeding under the Winding Up Act, to charge him as director, held that, having regard to his position as director of, and, therefore, agent for, the company, whatever benefits or profits accrued to him under the indemnity constituted by his secret agreement with the promoter belonged to the company, and that the retention by him of the proceeds of the indemnity occasioned a loss to the company for which he was accountable, with interest.[1]

[1] In re North Australian Territory Co., Archer's Case, Law Rep. (1892), 1 Ch. 322. LINDLEY, Lord Justice, in his opinion quotes from MELLISH, Lord Justice, in Hay's Case, Law Rep., 10 Ch. 593, 601, these words: "There is no doubt about the rule of this court, that an agent cannot, without the knowledge and consent of his principal, be allowed to make any profit out of the matter of his agency, beyond his proper remuneration as agent. It is perfectly-settled law that that rule applies, with peculiar stringency, to the directors of joint-stock companies, who are the agents of the company for effecting the sales or the purchases made by the company." FRY, L. J., in his opinion, said: "In Hay's Case [Law Rep., 10 Ch. 593], the company agreed to pay a sum of money to the vendors of the property. On one day they were paying a sum of £58,000, in part payment of that purchase money; cheques were drawn in favor of the agent of the vendors, and one of these cheques was indorsed over to Sir John Hay, and cashed by him. The company, therefore, were making a payment which they were bound to make, and they lost nothing, in one sense, by Sir John Hay receiving that money. The only loss they sustained was by Sir John Hay not accounting for it when he got it. It appears to me there was, therefore, exactly the same loss in that case as there is in the present case. Again, in Pearson's Case [5 Ch. Div. 336], the same observation can be made. The company there issued to its promoters, under an agreement, fully paid-up shares. Some of these shares were given by one of the promoters to Sir Edwin Pearson, one of the directors, on his qualification. The company, therefore, got all they stipulated for, all the shares that they issued and which were in Sir Edwin Pearson's hands, having been, by agreement, issued as fully paid up, and yet, because he ought not to have taken those fully paid-up shares, but ought to have paid the amount which was not payable by reason of the bargain between the company and the promoters, he was held liable to make good, and treat the shares as if they had not been paid up at all. It might be said in both these cases (in Hay's case the payment was by the vendors, and in Pearson's case the payment was by a promoter), that the company lost nothing by the money in the one case, and the shares in the other, reaching the hands of the director, but the court said in each case that, because the director was accountable, the company were losers to that extent. * * * On principle, I think the two cases to which I have referred are not distinguishable from the present." As to the liability, under this English statute, of a trustee or manager of a savings bank, to pay an adequate sum towards the assets of the bank by way of compensation for any loss occasioned to the bank by his neglect or omission, see In re Cardiff Savings Bank, Davies' Case, (1890) 45 Ch. Div. 537.

CHAPTER VII.

ULTRA VIRES — PUBLIC CORPORATIONS.

§ 256. Issue of negotiable securities.
257. Borrowing money by school districts.
258. Incurring liability in excess of funds in the treasury and amount of tax allowed for one year.
259. Incurring a debt without provision by taxation for interest and sinking fund.
260. Employment of an agent to negotiate bonds.
261. Investment of sinking funds.
262. Contract with corporation attorney for legal services.
263. Discount of its warrants by a corporation.
264. Illustrations of ultra vires contracts.
265. Estoppel of a public corporation to deny its liability on an ultra vires contract.
266. Estoppel of a contractor with a public corporation to enforce an ultra vires contract.
267. Injunction of public officials — rules.

§ 256. Issue of negotiable securities.—The officers or official agents of counties, as well as other municipal corporations, without express legislation, have no power to issue commercial paper and thereby impose upon the corporation the duties and liabilities incident to such paper.[1] In a case before the federal court a city had entered into a contract with a firm by which the latter agreed to vest title in the city to certain strips of land, to do certain other things with reference to widening a street, and to secure certain sewer privileges and the relocation of certain tracks of railroads, and the city agreed to pay them for such real estate and their services. In payment of the same the city issued to this firm certain "certificates of indebtedness" and delivered them to the bank to which the firm had contracted to sell them. It was held in the United States Circuit Court that, in the absence of any special statutory authority, a city had no right to issue such certificates in negotiable form, even in payment for property which it had authority to buy.[2]

[1] People ex rel. *v.* Johnson, 100 Ill. 537; People ex rel. *v.* Kingsbury, 100 Ill. 509; People ex rel. *v.* La Salle County, 100 Ill. 495.

[2] Bangor Savings Bank *v.* City of Stillwater, (1891), 46 Fed. Rep. 899. The provisions of the charter of the city were discussed by the courts, and the powers thereunder given were declared in the opinion. THAYER, J., said: "[The city] had [the] right [to contract with this firm for the acquisition of land and privileges], we think, under power conferred upon the city council * * * 'to open, establish, vacate and widen streets, to construct, maintain and extend sewers, and to condemn and purchase the lands necessary to be used for street and sewer purposes.' * * * These powers were sufficient to authorize the city council to contract with [the firm] to purchase the lands in question, and to render the services which they undertook to render for and in behalf of the city. But it is a different question whether the city had authority to pay for such services in the manner proposed; that is to say, by the issue of certificates of indebtedness, payable to order and running one, two and three years. Plaintiff's attorneys strenuously insist, and in that we agree with them, that the so-called 'certificates of indebtedness' are in reality negotiable bonds or notes, which, under the law-merchant, may be transferred by indorsement from hand to hand, so as to cut off equities of defense. In a recent case, which contains an elaborate review of previous decisions on the same subject, the doctrine was restated that municipal corporations have no power to utter commercial paper, unless it is expressly conferred upon them by law or is clearly implied from some other power expressly given. It was further held that no implication arises that a municipality may make commercial paper and put the same on the market from the fact that it is expressly authorized to borrow money. 'To borrow money,' say the court, 'and to give a bond or obligation therefor which may circulate in the market as a negotiable security, freed from any equities which may be set up by the maker of it, are, in their nature and in their legal effect, essentially different transactions. Merrill *v.* Town of Monticello, 138 U. S. 673; s. c., 11 Sup. Ct. Rep. 441, 448. See, also, Claiborne Co. *v.* Brooks, 111 U. S. 400, 486; s. c., 4 Sup. Ct. Rep. 489; Police Jury *v.* Britton, 15 Wall. 566; Young *v.* Clarendon Township, 132 U. S. 340; s. c., 10 Sup. Ct. Rep. 107. In the present instance it appears that the so-called 'certificate' or 'bond' remains in the hands of the original payee, the Bangor Savings Bank; it has not been negotiated, and it contains on its face a recital that it was issued in consideration of the performance by [this firm] of a certain contract * * * dated December 21, 1887,' which is notice to the holder of the provisions of that contract. No question of estoppel or touching the superior rights of a transferee for value can arise in this case. The point to be determined is simply whether the city of Stillwater had any authority, under its charter, to issue negotiable bonds to [this firm] for the land to be procured and the services to be rendered, and this question we think must be answered in the negative. By [a certain] section * * * of its charter 'the committee on finances of the city council, * * * upon order of the council, may, from time to time, borrow for and in behalf of said city such sums of money as may be necessary for temporary purposes, and to anticipate the current revenue only.' It is obvious, we think, that the issue of bonds to [this firm], under the circumstances and for

§ 257. Borrowing money by school districts.—As a general rule a corporation, either public or private, has an implied power to borrow money for objects expressly authorized by the statute by which it was created and endowed with corporate powers and privileges, but if such power is expressly or by

implication denied by such statute, then no such power exists. The trustee of a school township, for instance, in Indiana, under the provisions of the school law which, by implication, deny the existence of such a power, cannot negotiate a loan for money and execute a note for its payment.[1] But where money is thus borrowed for a school township district by its trustee, and actually and rightfully expended for the benefit of the school corporation it will be liable for the amount.[1] In a later case the Indiana Supreme Court adhered to the ruling that the trustee of a school corporation has no authority to borrow money and execute promissory notes therefor in the name of the corporation.[2]

the purpose explained, cannot be supported under this clause. Short, temporary loans, in anticipation of, and to be paid out of the current revenue for the year, is all that this section contemplates. Again, by [other] sections * * * the city was authorized to issue and sell bonds and put the avails thereof in the city treasury to create what is termed a 'permanent improvement fund.' Whether the city had already issued all the bonds authorized to create the permanent improvement fund does not appear, but that is immaterial, as, in our view, it could not issue the so-called 'certificates' under the sections of the charter last referred to, its duty having been in our judgment to pay [the firm] in money out of the 'permanent improvement fund,' as the charter seems to contemplate, instead of issuing to them negotiable bonds. The only other authority to be found in the city charter to issue negotiable paper is contained in [a section authorizing] an issue of bonds to meet other maturing bonds of the city when there was a deficiency in the 'sinking fund;' but it also contains the following important prohibition in the concluding paragraph of the section, to wit: 'But neither said city council nor any officer or officers of said city shall otherwise, without special authority of law, have authority to issue any bonds or create any debt or liability against said city in excess of the amount of revenue actually levied and applicable to the payment of such liability.'"

[1] Wallis v. Johnson School Township, (1881) 75 Ind. 368. The court said: "Section 7 [of the school law] provides, *inter alia*, that the trustee shall receive and pay out the special school revenue and also the revenue for tuition appropriated to his township, and shall pay out the same for the purposes for which such revenues were collected and apportioned. Section 10 in express words places the trustee in charge of all the educational affairs of the township and empowers him to employ teachers and to build and furnish school houses. These provisions do undoubtedly confer broad and comprehensive powers upon township trustees, and were there no restrictive provisions we should be compelled to hold that, with this broad grant of express powers, there was coupled the incidental one of borrowing money. We think, however, that there are restrictive provisions which, fairly construed, must be held to deny the authority to negotiate bonds. In section 6 it is provided that the county auditor, in fixing the penalty of the bond of trustees, 'shall see to their sufficiency to secure the school revenues which may come into their hands.' There is here a clear implication that the only money which a trustee can officially receive is that yielded by the school revenues. Money obtained by borrowing cannot be said to be school revenue. If an action were brought upon the trustee's bond, and the only breach shown should be the misappropriation of money obtained by borrowing it, it is clear that the action would fail, for the reason that the penalty of the bond extends only to money received from the school revenues. The sources from which school revenues are derived are created and defined by law, and it is from these sources only that the trustee has a right to secure money for school purposes."

[1] Wallis *v.* Johnson School Township, (1881) 75 Ind. 368. See, also, Bicknell *v.* Widner School Township, 73 Ind. 501. Where the money borrowed was actually used in paying for a school house, the township was held liable as "for money had and received, which was applied to the lawful use of the township."

[2] Union School Township *v.* First National Bank of Crawfordsville, (1885) 102 Ind. 464; citing in addition to the two cases last cited, First National Bank *v.* Union School Township, 75 Ind. 361; Pine Civil Township *v.* Huber Manufacturing Co., 83 Ind. 121; Reeve School Township *v.* Dodson, 98 Ind. 497. Upon this point it is said by the court in Union School Township *v.* First National Bank of Crawfordsville, (1885) 102 Ind. 464, 475: "It is true that we have held that where the money received on notes executed in the name of the school corporation goes to pay for property received by it, the person advancing the money will be subrogated to the claim of the person who actually furnished the property, but we have steadily held that it is only in cases where the school corporation actually received the property purchased, that subrogation can take place. It is well known that subrogation arises, not by contract, but by force of equitable principles, and only in cases where good conscience requires that it should take place in order to prevent injustice." Upon the subject of estoppel, it was said: "It is a fundamental principle that a governmental corporation is not estopped by the act of an officer in cases where the act is beyond the scope of his authority. Public corporations stand on an essentially different ground from private ones, and other rules which apply to the one class do not apply to the other in cases where the doctrine of *ultra vires* is invoked. Driftwood Valley Turnpike Co. *v.* Board, etc., 72 Ind. 226; Cummins *v.* City of Seymour, 79 Ind. 491, 497; s. c., 41 Am. Rep. 618. But the power of a school corporation is much more limited than ordinary public corporations, for there is no general power to incur debts or execute evidences of indebtedness, and, certainly, no such power exists where the school trustee is provided with money from the school revenues. The school corporation is, in truth, one of unusually limited powers, for the only source from which it can derive money is the school fund or school revenues, and, strictly speaking, its only power is to receive and disburse the funds allotted to it."

§ 258. Incurring liability in excess of funds in the treasury and amount of tax allowed for one year.— The Minnesota

statutes as to counties and their financial management have been construed by the Supreme Court of that state, and they have held that the board of county commissioners has no power to incur liability for the county, which, with the ordinary current yearly expenses and other liabilities payable within a year, will exceed both the amount of funds in the county treasury and the maximum amount which can be assessed as one year's taxes for county purposes according to the tax lists on file when the contract is made under which the liability will be incurred. Nor can the board, in addition to anticipating the above resources, in incurring liability also anticipate uncollected taxes. It has no power to anticipate in a year more than a year's uncollected taxes assessed at the maximum rate. They held further that, under the general laws of that state, a board of county commissioners has no power to issue bonds for the erection of a court house.[1] The same court in a recent case held that a contract made by the city council of a leading city of that state for lighting its streets for a term of five years was, under its charter, void, unless the funds on hand and the taxes actually levied when the contract was made were sufficient to cover all the liability incurred by the contract and payable during the five years, and also to cover the current expenses and other existing liabilities of the fiscal year for which such taxes were levied; further, the conditions required to make the contract valid were so exceptional that its validity would not be presumed.[2] The United States Circuit Court for

[1] Rogers *v.* Board of Comrs. of Le Sueur County, (Minn. 1894) 59 N. W. Rep. 488. See, also, Johnston *v.* County of Becker, 27 Minn. 64; s. c., 6 N. W. Rep. 411.

[2] Kiichli *v.* City of Minneapolis, (Minn. 1894) 59 N. W. Rep. 1088. The court, after reciting the various sections of the charter regulating the financial conduct of the city's affairs, said: "It is urged that making a contract this year, to be performed in part this year, in part next year, and in part the year after, and paid for only as performed, is not incurring liability at the time the contract is made, as the tax will be levied before the debt is created; that is, before the liability matures. To this it may be answered that a liability is incurred when the contract is made. The point here involved is disposed of in the cases of Johnston *v.* County of Becker, 27 Minn. 64; s. c., 6 N. W. Rep. 411, and Rogers *v.* Board of Comrs., (Minn. 1894) 59 N. W. Rep. 488, where the court held that a liability was incurred when the contract was made, though not to be performed, or the performance paid for, until after the taxes of subsequent years would be available to pay it. There the county commissioners were limited in incurring liability to the maximum amount which could be levied in one year according to the tax lists then on file. Here the limitation is more stringent. It limits the city council, in incurring liability, to the amount of the tax 'actually levied' at the time the liability is incurred."

[1] Budd *v.* Budd, (1894) 59 Fed. Rep. 735.

the western district of Missouri has held that the charter provision forbidding the council of a city to appropriate any money in excess of the revenue for the fiscal year actually collected or to bind the city by any contract or act in any liability until a definite sum shall first be appropriated for the liquidation of all liability flowing therefrom, did not apply so as to prevent the council accepting a devise of lands for a public park, subject to an annuity to the widow of the devisor during her life, which annuity was paid by annual appropriation from the general fund, as the council was vested by other provisions of the charter with ample powers to acquire land for this purpose, either by devise, or by actual purchase, to be paid for out of the general funds in annual installments.[1]

§ 259. Incurring a debt without provision by taxation for interest and sinking fund.— A city in Texas contracted for the building of a bridge, agreeing to pay a certain sum therefor, one-half on delivery of the material and the remainder on completion and acceptance of the bridge. This contract was held in the United States Circuit Court to create a debt within the constitutional provision that no city shall create any debt unless at the same time provision be made by taxation for payment of interest and creation of a sinking fund. The contract was, therefore, in case no such provision was made for interest and sinking fund, held invalid, notwithstanding payment of the contract price was secured by the proceeds, paid into the city treasury, of bonds issued for that purpose in accordance with the provisions of the charter of the city requiring creation of a fund for payment of interest and as a sinking fund by special tax; also, it was held that a debt created by such contract could not be regarded as a current expense of the city payable out of current revenues. And there could be no recovery upon a contract void as in contravention of the constitutional provisions of the value of the bridge as upon an implied contract.[2]

[2] Berlin Iron Bridge Co. *v.* City of San Antonio, (1894) 62 Fed. Rep. 882. See City of Corpus Christi *v.* Woessner, 58 Tex. 462; Biddle *v.* City of Terrell, 82 Tex. 335; s. c., 18 S. W. Rep. 691; City of Terrell *v.* Dessaint, 71 Tex. 773; s. c., 9 S. W. Rep. 593;

§ 260. Employment of an agent to negotiate bonds.— In a late California case the action was against a county by one upon a contract with the county board to secure bids for county bonds. The Supreme Court held the employment of this person by the county board for this purpose to be a void act, and that his acts in pursuance of such employment, however beneficial they may have been to the county, created no liability against it.[1]

Bell *v.* Live Stock Co., (Tex.) 11 S. W. Rep. 344; City of Bryan *v.* Page, 51 Tex. 532.

[1] Smith *v.* County of Los Angeles, (1893) 99 Cal. 628; s. c., 34 Pac. Rep. 439. Upon the power of the county board to make this contract, the court in discussing the point states the following provision of the "County Government Act" of that state: Section 25 of the act provides that "the board of supervisors in their respective counties have jurisdiction and power, under such limitations and restrictions as are prescribed by law," to create a bonded indebtedness and to issue bonds of the county, as provided by section 37 of said act, and subdivision 14 of section 25 provides that "whenever bonds issued under this chapter shall be duly executed * * * they shall be delivered to the county treasurer, and his receipt taken therefor, and he shall stand charged on his official bond with all bonds delivered to him and the proceeds thereof, and he shall sell the same or exchange them under the direction of the board of supervisors. * * * He shall also keep a record of bonds sold or exchanged by him, * * * and shall also report, under oath to the board, at each regular session, a statement of all bonds sold or exchanged by him since the preceding report, and the date of such sale or exchange * * * and the amount of accrued interest received by him on such sale or exchange, * * * but such bonds shall not be sold or exchanged for any indebtedness of the county, except by the approval of the board of supervisors of said county. No sale shall be made of any such bonds except to the highest bidder, after advertising bids for the purchase of the same" in the manner prescribed. And subdivision 35 of the same section empowers the board "to do and perform all other acts and things required by law not in this act enumerated, or which may be necessary to the full discharge of the duties of the legislative authority of the county government." Section 6 of the same act provides that "all contracts, authorizations, allowances, payments and liabilities to pay, made or attempted to be made in violation of this act, shall be absolutely void, and shall never be the foundation or basis of a claim against the treasury of such county. * * *" And section 36 thereof provides that "the board must not for any purpose contract debts or liabilities except in pursuance of law." The court then said: "It is clear that these provisions of the statute confer no express power upon the board of supervisors to make such a contract as the one sought to be recovered on in this action; and unless it can be implied from subdivision 35 referred to, then it follows that no such power exists, and the contract sued on is, therefore, void, because not made in pursuance of law. As the [County Government Act] distinctly enumerates the acts which the board is required to perform with reference to the issuance and disposal of county bonds; and, as the employment of a procurer of bids for bonds delivered to the treasurer for sale or exchange under the law was not in any way necessary to the full discharge of the legislative authority of the county government, no such implied authority to make such a contract was conferred upon the board as contended for. The board of supervisors cannot sell or negotiate the sale of its county bonds. That power is expressly conferred by statute on the county treasurer, and is to be exercised by him under the direction of the board, and the sale or exchange of bonds by him is made subject to the approval of the board; in other words, the bid for the bonds is solicited and obtained upon the advertisement by the treasurer for such bid, and the law recognizes no other mode of procurement. The treasurer alone procures the bid, the mode and manner of such procurement being specifically pointed out by statute. The making of the contract in question by the board of supervisors was an unwarranted, if not a pragmatical, interference with the power and duties of the county treasurer as expressly conferred and defined by law."

§ 261. Investment of sinking funds.— The Supreme Court of Illinois refused a writ of *mandamus* to compel the treasurer of a county to invest funds of the county, held as a sinking fund, to pay legally issued bonds of the county, in certain other securities of the county, as directed by a resolution of the board of county commissioners. In the opinion they state that the contention of the petitioner was, that there was an implied power in the board to order such investment, embraced in the provision conferring upon county boards power "to manage the county funds and county business, except as otherwise specially provided." Of this contention, the court said: "This cannot be understood to give to county boards the absolute and unlimited power of management of county funds, where there is the absence of any specific provision of law to the contrary. It hardly means more, we think, than a power to manage the county funds and county business according to law. See Rothrock *v.* Carr, 55 Ind. 334. We certainly cannot allow to it any such scope as giving a general power to county boards to invest surplus funds in the county treasury in such manner as they shall see fit. So far from there being any provision of law which, in express words, or by necessary implication, authorizes the action taken by the county board in this case, section 39, 'that whenever a tax is levied for the payment of a specific debt, the amount of such tax collected shall be kept as a separate fund in the county treasury, and expended only in the liquidation of such indebtedness,' would seem to prohibit the doing of what has been here attempted. We would not be understood, however, as applying this provision with such strictness as to deny all power of investment what-

ever of the moneys of a sinking fund, and compel them to remain *in specie* in the county treasury, and lie idle and unproductive until required to be applied to the purpose for which they were raised. In Union Pacific Railroad Co. *v.* The United States, 99 U. S. 700, the court remark: 'The duty of the manager of every sinking fund is to seek some safe investment for the moneys as they accumulate in his hands, so that when required they may be promptly available.'" The Illinois court then continued: "An investment, for instance, in the public funds of the United States is, all know, so readily convertible into money, that it would be, essentially, the equivalent of money. Such an investment, we are not prepared to say, would be incompatible with the requirement that the money represented by such investment should be kept as a separate fund in the county treasury, and expended only in liquidation of the indebtedness it was raised to pay. But the same cannot be affirmed of county securities, as to their being the representative of money. Constant experience shows that the promises to pay of a county are quite different from being the equivalent of money in hand."[1] A Texas city, having determined by its council, to invest certain sinking funds, in the hands of its treasurer, in bonds of the city of another series, gave certain warrants for the amount to the parties through which it proposed to make the investment against those sinking funds. The treasurer declined to honor them. The city then brought its writ to compel him, by *mandamus* to pay, as directed, these warrants. He resisted upon various contentions. Among others, was this contention: That, if the city could invest these funds otherwise than in paying off and canceling the bonds themselves, it could not invest them in the purchase of its own outstanding bonds of another series, because a purchase by a debtor of a debt against himself *ipso facto* works a cancellation thereof. Over this contention the Court of Appeals of that state held that the power to invest in its own bonds of another series existed in the city.[2]

[1] Cook County *v.* McCrea, (1879) 93 Ill. 236, 239, 240.

[2] Elser *v.* City of Fort Worth, (Tex. Civ. App. 1894) 27 S. W. Rep. 739. *Arguendo*, the court said: "It must be conceded that [the statement of the contention] is a correct statement of the law in its application to ordinary cases in which the purchase is made by the debtor in the same capacity in which he owes the debt, but even in such cases, it is very easy to keep the security alive by having the creditor make a transfer to a third party. 1 Jones' Mortg. 943–946. Also, see Jones' Corp. Bonds & Mortg. 325, where it is said: 'A company may purchase its own bonds as an investment, and reissue them. If the facts show that there was no intention of paying the bonds, but they were regarded and reputed by the company as still outstanding, they are valid in the hands of a subsequent purchaser, and are secured by the lien of the mortgage.' But, be this as it may, it will hardly be contended that if the purchase be made in a different capacity than that in which the debt is owed (for instance, if A., as trustee, should, with the trust fund, purchase a debt which he owes as an individual), the rule would apply, and we are of opinion that as to those funds set apart for special purposes, both by the law and by the ordinances passed by the city council, as in this case, the city must be regarded as a trustee purchasing with the trust fund a debt which it owes as an individual, and that the debt so purchased is not canceled, but is kept alive for all purposes, and becomes the property of the *cestui que trust* — the special fund — just as the house and lot taken from a defaulting collector was said by our Supreme Court, in the case of City of Sherman *v.* Williams, 84 Tex. 421; s. c., 19 S. W. Rep. 606, to become the property of such a fund. We think this view receives striking illustrations in numerous provisions of our Constitution and laws, authorizing the investment of special funds, such as the university and public schoo. funds, held by the state; in its own bonds, and by the different counties in their own obligations. We believe that it has never been contended that a purchase of this kind cancels the bonds thus acquired. We do not regard the opinions in the cases of Bank *v.* Grace, 102 N. Y. 313; s. c., 7 N. E. Rep. 162, and Wilds *v.* Railroad Co., 102 N. Y. 410; s. c., 7 N. E. Rep. 290, as conflicting herewith. Those decisions were controlled entirely by the statutes and ordinances therein construed, which were quite dissimilar to the provisions contained in the charter of this city."

§ 262. Contract with corporation attorney for legal services.—The question of whether the commissioners of a county in Pennsylvania were authorized to make a contract with the county solicitor to take proceedings to obtain credit for the county in its accounts with the commonwealth for all unpaid taxes on personal property, for which he was to have as compensation twenty-five per centum upon the amount or amounts which might be credited, received the full consideration of the Supreme Court of that state, and they held that such contract was *ultra vires*.[1] The Supreme Court of Kansas has held a contract made

[1] County of Lancaster *v.* Fulton, (1889) 128 Pa. St. 48. The court, speaking through STERRETT, J., said: "In substance, the defense interposed by the county was, that at the time the resolution [referring to the contract] was adopted plaintiff below 'was the duly elected and qualified solicitor' of the county, serving under the act of February 18, 1870, at a salary of five hundred dollars, fixed by that act; and, for that reason, neither he nor the county commissioners had any power or authority to enter into the contract, under which the services were rendered and on which the claim is founded. It is conceded that when the contract was made and for a considerable time thereafter plaintiff below was the duly elected and qualified solicitor of the county. The

by the board of county commissioners for the county with attorneys at law, for their services as such, which services the law requires the county attorney to perform, *ultra vires* and void.[1]

§ 263. Discount of its warrants by a corporation.— A county in North Dakota created from portions of two other

4th section of the act under which he was elected declares: 'The salary of the officer elected as hereinbefore provided shall be five hundred dollars per annum, payable quarterly; and the officer so elected shall be the legal adviser of the board of commissioners of Lancaster county, and shall represent the said board in all proceedings in law or equity wherein the said county is a party or has any interest.' He was undoubtedly a public officer within the meaning of the Constitution, article III, § 13, and article XIV, §§ 1 and 5, the first of which declares: 'No law shall extend the term of any public officer or increase or diminish his salary or emoluments after his election or appointment.' The services for which the contract in question undertakes to provide are clearly within the sphere of the duties of the 'solicitor of Lancaster county' as defined by the act of February 18, 1870. He 'shall be the legal adviser of the board of commissioners of Lancaster county and shall represent the said board in all proceedings in law or equity wherein said county is a party or has any interest.' What authority then had either the plaintiff below or the county commissioners to enter into a contract to compensate the former for services within the sphere of his duties as solicitor of the county? We are of opinion that they had none; that the act of the commissioners in undertaking to bind the county to pay the compensation provided for in the contract was *ultra vires*. Doubtless the very object of the act in creating the office of county solicitor, providing for his election and fixing his salary, etc., was to take the power out of the hands of the county commissioners and place it beyond their reach. But, be that as it may, we think the contract was *ultra vires* and void. * * *" Further on, referring to the trial judge's charge, it is said: "In saying, as he correctly did, that if the services of plaintiff below 'had been rendered while he was county solicitor, then there could be no recovery,' the learned judge rightly assumed that the contract in question was unauthorized and illegal. All such contracts, whether intended to be so or not, are in effect evasive and subversive of law, contrary to public policy, and, therefore, void. They are no more capable of ratification than was the contract in Hunter *v.* Nolf, 71 Pa. St. 282. Speaking of the illegal contract under consideration in that case, Mr. Justice SHARSWOOD said: 'It is undisputed law that such a contract is illegal as against public policy and cannot be enforced. Even if there had been an express contract on entirely different terms than those agreed upon before, it ought to be viewed with a considerable degree of suspicion as an attempt to evade a sound and salutary rule of public policy.' A case more nearly parallel with this in some of its features is Chester County *v.* Barber, 97 Pa. St. 455. Barber, one of the plaintiffs below, was attorney for the county of Chester, but it did not appear whether he was serving under an annual salary

[1] Waters *v.* Trovillo, (1891) 47 Kans. 197.

counties, though its board of commissioners, made a contract with one to make a transcript of the records of those two counties so far as they affected the territory embraced in the new county at an agreed price for which he was to be paid in a county warrant for such a sum as, at the prevailing discount of such warrants, would raise the amount which was to be paid him. The validity of these warrants issued by the county was contested in the courts. The Supreme Court held the warrant to be wholly illegal and void from its inception, for the reason that the county commissioners, in the absence of legislative authority, either general or special, to do so, were without power to enter into such an arrangement.[1] One of the warrants sued on in this case repre-

fixed by act of assembly or under a special agreement with the commissioners. The county commissioners, however, made a contract with him and two other attorneys to pay them fifty per centum of the amount they recovered from the state for taxes improvidently paid into the state treasury. Speaking for the court, the present chief justice said: 'The commissioners had no power to bind the county by such a contract. * * * It was against public policy, and, therefore, null and void. * * * These commissioners were acting in a fiduciary character. They were but trustees of the money when received for the use of the county. When, therefore, they contracted to give one-half of it to the plaintiffs for their services they exceeded their power. They were giving what did not belong to them. As well might a trustee contract to give away one-half of the trust estate as compensation to counsel for services in connection therewith. And, if he may give away one-half, why not three-fourths, or even a greater proportion? Can it be doubted that a court of equity would strike down such a contract as improvident and a legal fraud? * * * Whether the plaintiff Barber can recover anything will depend upon the terms of his previous engagement as solicitor to the commissioners.' If it had appeared in that case that Barber was acting under a salary, fixed by act of assembly (as was Mr. Fulton in this case), and that his defined duty was to act as a legal adviser of the commissioners and represent them in all proceedings at law or in equity wherein the county had any interest, it is not likely that any doubt as to his legal status would have been suggested. According to the reasoning of the opinion the contract as to him would have been declared illegal, contrary to public policy, and absolutely void. We are, therefore, of opinion that the learned judge erred in holding that plaintiff below might recover if the commissioners recognized his services after the expiration of his term of office as county solicitor; that such recognition would be a ratification of the original illegal agreement, etc."

[1] Erskine *v.* Steele County, (N. D. 1894) 60 N. W. Rep. 1050. The holders of the warrant cited specially in support of their position the case of Kilvington *v.* City of Superior, 83 Wis. 222; s. c., 53 N. W. Rep. 487. The Supreme Court of North Dakota referred to that case in these words: "In [that case] the court held that

sented entirely the discount of the warrant which was issued to the contractor for transcribing the certain records of the two counties from which this county was created. This warrant the Supreme Court of North Dakota held also to be wholly illegal and void for the reason that the county commissioners were without power to enter into an agreement for such discount.[1]

the general power conferred upon village trustees to 'appoint a board of health to prevent the deposit of unwholesome substances, and prevent or abate nuisances, is sufficient to authorize a contract for the erection of a crematory for the consumption of any matter calculated to affect the health or comfort of the community.' The reason of this holding is plain. While the authority to erect a crematory was not expressly conferred by the legislature upon the trustees, such authority was implied if necessary in carrying out the power to abate nuisances, etc., which power was given in clear terms. But we see no analogy in the case cited to the case at bar. The right to enter into such a contract, as that concluded with the [one who did the transcribing] was not expressly conferred upon the commissioners, nor was such authority necessary or at all appropriate to the execution of any power vested in the commissioners by any law of the territory then existing. In the absence of legislative authority authorizing it any such contract was, in our opinion, clearly *ultra vires* in character. We, therefore, hold that the warrant was wholly void from its inception. It was issued without authority of law and upon no legal consideration. Rasmusson *v.* County of Clay, 41 Minn. 283; s. c., 43 N. W. Rep. 3; Pugh *v.* Good, 19 Or. 85; s. c., 23 Pac. Rep. 827."

[1] Erskine *v.* Steele County, (N. D. 1894) 60 N. W. Rep. 1050. Upon this branch of the case, the court said: "Essentially the same question has been frequently presented to courts in other jurisdictions, and the authorities, so far as we have examined them, are unanimous in condemning such discount transactions. Judge DILLON, in his learned treatise upon Municipal Corporations (Vol. 1 [4th ed.], § 503), says: 'Without express authority from the legislature, a municipality cannot discount its warrants for more than the sum actually due the claimant, and as to the excess they are void, and the holder will be treated only as the equitable assignee of the valid, legal claim of the payee.' In Foster *v.* Coleman, 10 Cal. 278, a claim for services to the amount of $1,650 was allowed by the board of supervisors. County warrants of the county were then at a discount, and worth only forty cents on the dollar. The board ordered a warrant to issue for a sum which, at this prevailing discount, would sell for $1,650, the amount due the claimant. Upon such order the warrant issued. A taxpayer of the county brought suit and the county treasurer was enjoined from paying the warrant. The Supreme Court, in the course of its opinion, referring to the order of the board directing the warrant to issue, said: 'The effect of the order was to create a debt or liability on the part of the county, and this the supervisors were not empowered to do for any purpose except as provided by law. Their action was entirely without authority, and altogether indefensible.' The settlement and allowance of an illegal claim against the county when made by a county

§ 264. Illustrations of ultra vires acts.— Furnishing aid to a gravel road or turnpike company in building or repairing its road at the expense of a county, or entering into contracts with them for the future repairs of a bridge or the approaches of a bridge, being beyond the powers of a county, a board of commissioners of a county have no authority to make contracts for such purposes.[1] Without enabling authority a municipal corporation cannot purchase lands and lots at a tax sale. Such a power is not included in a general authority to buy and hold real estate for the convenience of the corporation.[2] But where a municipal

board, has no more conclusive effect than such an adjustment would have if made by private persons. See Commissioners *v.* Keller, 6 Kans. 511. In a recent case clearly in point, the Supreme Court of the state of Washington, in referring to the act of a municipality in discounting its own warrants, uses the following language: 'Such a proceeding is manifestly beyond the scope of legitimate corporate power, and a practice of that character might lead to various results. City warrants are evidence of indebtedness, or promises to pay, and are payable with interest prescribed by law; and the corporation cannot cast upon the taxpayers any further burden in respect thereto, and the courts have uniformly, as far as we are advised, disapproved of any effort to do so.' Arnott *v.* City of Spokane, 6 Wash. St. 442; s. c., 33 Pac. Rep. 1063. See, also, Clark *v.* Des Moines, 19 Iowa, 199; Bauer *v.* Franklin County, 51 Mo. 205; Shirk *v.* Pulaski County, 4 Dill. 209: s. c., Fed. Cas. No. 12,794." See Pugh *v.* City of Little Rock, 35 Ark. 75.

[1] Driftwood Valley Turnpike Co. *v.* Board of Comrs. of Bartholomew County, (1880) 72 Ind. 226. The court said: "In the case of Harney *v.* Indianapolis, etc., R. R. Co., 32 Ind. 244, it was held that a county had no power, without affirmative legislation, to make an appropriation from its treasury by way of donation to a railroad company to aid in the construction of its road. The court, among other things, said: 'The counties are corporations created for the purpose of convenient local municipal government, and possess only such powers as are conferred upon them by law. They act by a board of commissioners whose authority is defined by statute. One of the powers conferred is to collect taxes levied upon the people and property within the county. In the disposition of the money thus collected into the general treasury the board has not unlimited discretionary choice as to the objects upon which it shall be expended. It can only be applied to certain specified objects, and the building of railroads is not one of these objects, or necessary to carry into effect any of the purposes for which such corporations were created.' In Burnett *v.* Abbott, 51 Ind. 254, the county board made a contract conditionally to pay certain expenses of boring wells for oil and digging for minerals. The contract was held void for want of authority to enter into it. Nor can the board appropriate the funds of the county to the payment of the debts of a county agricultural joint-stock company or to the building of school houses. Warren County Agricultural Joint-Stock Co. *v.* Barr, 55 Ind. 30; Rothrock *v.* Carr, 55 Ind. 334."

[2] City of Champaign *v.* Harmon, (1881) 98 Ill. 491. It was said by the

corporation is vested with general authority to purchase real estate for any purpose, a vendor of land to a municipal corporation will not be allowed to avoid his contract by insisting that his deed is void, because the corporation may have exceeded its powers in making such purchase.[1] In a case before the Supreme Court of Alabama, an action to enforce a penal bond given by a

court: "Municipal corporations are creatures of the statutes, and can only exercise such powers as are expressly conferred, or such as arise, by implication, from general powers granted. In this case the plaintiff corporation is empowered by its charter to buy and hold real property, but that must be understood to be purchases made in the ordinary way, and only for corporate purposes, and a grant to purchase real property for particular purposes would seem to be a limitation on the powers of such corporations, and would exclude, by necessary implication, all purchases for mere speculation or profit. Power to purchase real estate for speculative purposes is not among the usual powers bestowed on municipal corporations, nor does such power arise, by implication, from any of the ordinary powers conferred on such corporations. Authority to buy and hold real estate is only given to them to that extent that may be necessary to carry into effect corporate powers granted. Under a general grant of power to buy and hold real property, it is understood municipal corporations may buy and hold such property, within the corporate limits, as may be necessary for corporate purposes, and may even buy and hold real estate beyond the corporate limits, for the location of cemeteries, pest houses and other purposes connected with the sanitary condition of the municipality."

[1] City of Champaign *v.* Harmon, (1881) 98 Ill. 491. In Halstead *v.* Mayor, etc., of New York, (1850) 3 N. Y. 430, the Court of Appeals of New York held that it was beyond the power of the corporation to assume the defense of suits brought against the county supervisors individually for the penalty incurred by them for neglecting the duty of auditing the salaries of certain judges appointed under a statute which they assumed to be unconstitutional, and was afterwards held to be unconstitutional, or to pay the judgments and costs recovered against those supervisors, upon the principle that such corporations are creatures of limited powers, especially upon the subject of the appropriation of the funds of the people, as settled in Hodges *v.* City of Buffalo, 2 Den. 110. *Ultra vires* contracts of municipalities: Bourdeaux *v.* Coquard, 47 Ill. App 254; Sang *v.* City of Duluth, (Minn.) 59 N. W. Rep. 878; City of Aberdeen *v.* Honey, 8 Wash. 251; s. c., 35 Pac. Rep. 1097; Penley *v.* City of Auburn, 85 Me. 278; s. c., 27 Atl. Rep. 158; East St. Louis Gas Light & Coke Co. *v.* City of East St. Louis, 47 Ill. App. 411; Hayward *v.* Board of Trustees of Town of Red Cliff, (Colo.) 36 Pac. Rep. 795; Town of Newport *v.* Batesville & B. Ry. Co., 58 Ark. 270; s. c., 24 S. W. Rep. 427; Lamar Water & Electric Light Co. *v.* City of Lamar, (Mo.) 26 S. W. Rep. 1025; Griswold *v.* City of East St. Louis, 47 Ill. App. 480; Hamilton *v.* City of Shelbyville, 6 Ind. App. 538; City of Nashville *v.* Sutherland, 92 Tenn. 335; State *v.* City of Bayonne, 55 N. J. Law, 268; Hintrager *v.* Richter, 85 Iowa, 222; Bateman *v.* City of Covington, 90 Ky. 390.

private corporation to a municipal corporation for the faithful application by the private corporation of bonds of the municipal corporation loaned by it, without authority under its charter, to aid in the construction of the works of the private corporation, the bond was held to be invalid and not enforceable by suit; further, that its validity was not affected by the subsequent sale or transfer of the municipal bonds by the private corporation, and that the private corporation contracting with the municipal corporation for the construction of works which the latter had no authority to construct and had received the benefit of the contract, was not estopped when sued by the municipality from setting up its want of authority to make the contract.[1]

§ 265. Estoppel of a public corporation to deny its liability on an ultra vires contract.— A manufacturing corporation which furnished school furniture to a school district of Kansas brought its action against the district to recover the value of the goods sold and delivered to it. It appeared in the pleadings and record before the Supreme Court, that the court below took the view that the written order set up in the petition, and, also, the written contract made by the board of directors with the agent of the plaintiff for the furniture, were void because unauthorized. The Supreme Court, having referred to the findings of the court below that the furniture had been in use by the school district for a period of nearly five and a half years, said: "It may be conceded, for the purpose of this case, that both these written instruments were void, and that no action could be maintained on either or both of them, yet the defendant district, having received and retained the property, which the court finds to have been fairly worth the price stated in the written contract, is

[1] City Council of Montgomery *v.* Wetumpka Plank Road Co., (1857) 31 Ala. 76. The court said: If the [doctrine *contra* the text] be established, these corporations, no matter how limited their powers, may make themselves omnipotent. They have only to induce persons to contract with them beyond the scope of their powers and their very usurpations have the effect of conferring powers on them which the legislature have withheld. A proposition so erroneous can scarcely need argument to overturn it. See on this point Pennsylvania, Delaware & Maryland Steam Nav. Co. *v.* Dandridge, 8 Gill & J. 248, 319, 320, and authorities cited; Albert *v.* Savings Bank of Baltimore, 1 Md. Ch. Dec. 407–413; Smith *v.* Ala. Life Ins. & Trust Co., 4 Ala. 558; Hodges *v.* City of Buffalo, 2 Denio, 110; Life & Fire Ins. Co. *v.* Mechanic Fire Ins. Co., 7 Wend. 31; New York Firemen Ins. Co. *v.* Ely, 5 Conn. 560.

bound, in common honesty, to pay for it. During all the time this furniture has been in the possession of the defendant district, it is fair to presume that the school house which was furnished with the seats and desks purchased from the plaintiff, was used in the same manner as school houses are ordinarily used. It is fair to presume that school district meetings were therein held annually at the time appointed by law. It is fair to presume that the school district board met there and caused the seats to placed in the building and to be used by the district. The board and the residents of the school district must all have known of the use of this property, and their continued retention and use of it shows a perfect and complete ratification of the purchase made by the district officers." In the case of Sullivan *v.* School District, 39 Kans. 347, it was held that a contract for the construction of a school house, made by one member of the school district board alone, on behalf of the district, might be ratified and made binding on the whole school district. This case came again before this court, and is reported in 48 Kans. 624, and the court then held that: "A contract for building a school house, void because made only by one member of the school board, may be ratified and made binding by the action of the school district in completing the building left unfinished by an absconding contractor, by furnishing the same with seats, desks and other necessary school house furniture, by occupying the same for school house purposes, and by insuring the same."[1] A bill was filed by a taxpayer in Iowa against the vendor of land sold to a county for a poor house farm, the county treasurer and supervisors, to which the county was not made a party, to have the contract set aside as being *ultra vires*, and the treasurer enjoined from paying certain warrants issued for the residue of the purchase money (the county having paid a part of the purchase money and been placed in possession). The Supreme Court held that the bill was not maintainable in a court of equity, because such a decree would be inequitable while the county was allowed to retain the land, and its title could not be disturbed in an action to which it was not a party.[2] A corporation which has enjoyed the provis-

[1] Union School Furniture Company *v.* School District No. 60, in Elk County, (1893) 50 Kans. 727, 730, 731.

[2] Turner *v.* Cruzen, (1886) 70 Iowa, 202; s. c., 30 N. W. Rep. 483. The court said: "It appears to us to be well settled as a rule, with one exception, that, where the consideration received by a corporation under an *ultra vires* contract can be restored, a court of equity will not relieve the corporation, as against the contract, without providing for a restoration of the consideration. Pratt *v.* Short, 53 How. Pr. 506; Leonard *v.* City of Canton, 35 Miss. 189; Argenti *v.* San Francisco, 16 Cal. 255, 282; Moore *v.* Mayor, etc., of New York, 73 N. Y. 238; Lucas County *v.* Hunt, 5 Ohio St. 488." Afterwards it was said: "We are aware that there is a class of cases where courts of equity declare a contract *ultra vires*, and grant relief in favor of a corporation, without any decree for the restoration of the consideration received by the corporation. This is so where municipal bonds have been issued in excess of the constitutional limit of indebtedness, and the money obtained thereon has been expended. Courts of equity decree the cancellation of such bonds, or enjoin payment, without decreeing repayment to the bondholders of the money received by the corporation on the bonds. But this results from the necessity of the case. If the courts should decree repayment, the very object of the constitutional provision would be defeated."

ions of a lease from a city, cannot, in an action for rent, claim that neither it nor the city had power to execute the lease.[1] It was insisted in an Indiana case that as a county had received the full benefit of a contract which it was beyond its power to make, it was estopped to set up that it was *ultra vires*, and to sustain this position counsel relied upon State Board of Agriculture *v.* Citizens' Street Railway Company, 47 Ind. 407. The Supreme Court said: "That, however, was the case of a private corporation, the street railway company, that sought to avoid its obligation on the ground of want of power to make the contract. There is a broad difference between a private corporation organized for a private purpose, though subserving a public interest, and a public corporation, like a county or city, organized for public purposes only, and whose obligations must be paid from public funds raised for public purposes only. The latter class of corporations may always defend, on the ground that the supposed contract was outside of the authority conferred on it by law. In

[1] City of Corpus Christi *v.* Central Wharf & Warehouse Co., (Tex. Civ. App. 1894) 27 S. W. Rep. 803. The court said: "There was nothing [in this lease contract] immoral or illegal, in the sense of an infraction of a positive prohibition of law, in the action of either party. At most, their action was in excess of the powers conferred. The restrictions upon the powers of the city government are imposed by law for the protection of the inhabitants of the city and the general public. By proper proceedings, taken by the right parties in due time, all such transgressions of power may be promptly remedied. But, when such contracts have been allowed to stand until fully carried out, it does not lie in the mouth of the party who received their benefits to urge the defense of *ultra vires*." See Bigelow Estop. 465; 7 Am. & Eng. Encycl. Law, 29; Beach Priv. Corp. §§ 421–426, 432, 433. As to a taxpayer having no right to complain of an illegal

1 Dillon Munic. Corp. § 381, the author, after stating the general doctrine, that the officer of a municipal corporation cannot bind the corporation by any contract which is beyond the scope of its powers, or entirely foreign to the purposes of the corporation, says: 'It results from this doctrine that unauthorized contracts are void, and in actions thereon, the corporation may successfully interpose the plea of *ultra vires*, setting up as a defense its own want of power under its charter, or constituent statute, to enter into the contract.'"[1] A county is not estopped as against a warrant issued by one of its officers, from setting up the defense of *ultra vires*.[2] The Kansas Supreme Court has said, upon this matter of estoppel of a corporation: "The tendency of the courts and others, at the present time, is to treat corporations, including municipal corporations, with respect to their business transactions, about the same as the courts and others treat individuals, and where a corporation, municipal or otherwise, has received benefits from others, upon contracts *ultra vires* or void because of some irregularity or want of power in their creation, but not void because made in *violation* of express law, or good morals, or public policy, and where the corporation retains such benefits, it must pay for them."[3] Where the acts of a municipal corporation are such as the corporation is prohibited from performing, they will be *ultra vires* and void, and the corporation and its taxpayers will not be estopped from insisting upon such invalidity even as against parties acquiring rights without knowledge of the fact.[4]

§ 266. Estoppel of contractor with a public corporation to enforce an ultra vires contract.—In an action by citizens and taxpayers of a town to restrain a contractor from enforcing a judg-

contract on the part of a city, such contract being voidable only at the option of the city, see Waco Water & Light Co. *v.* City of Waco, (Tex. Civ. App. 1894) 27 S. W. Rep. 675.

[1] Driftwood Turnpike Co. *v.* Board of Comrs. of Bartholomew Co., (1880) 72 Ind. 226.

[2] Webster County *v.* Taylor, 19 Iowa, 117. In Woodruff *v.* Commissioners of Noble County, (Ind. App. 1894) 37 N. E. Rep. 732, it was held that a county physician could not contend that a contract by the board with the county medical society, for medical treatment of the poor of the county, was *ultra vires* the society and did not bind its members.

[3] Board of Comrs. of Hamilton County *v.* Webb, (1891) 47 Kans. 104, 105, 106; citing City of Ellsworth *v.* Rossiter, (1891) 46 Kans. 237, 242; Comrs. of Leavenworth Co. *v.* Brewer, 9 Kans. 307; Huffman *v.* Comrs. of Greenwood County, 23 Kans. 281.

[4] McPherson *v.* Foster, 43 Iowa, 48.

ment against the town obtained by default and to restrain the town and its officers from paying this contractor anything upon his alleged contract upon which the judgment was rendered, it being alleged in the complaint that the judgment was obtained through the connivance of the officers of the town, it appeared that the town was empowered by its charter to levy special assessments for opening and grading streets upon the real estate in front of, or adjacent to, which such improvements should be made. A later act provided for the assessing of the costs of such improvements in the first instance upon the property deemed to be benefited thereby; and, further, it was provided in this later act that the town council should "order said improvements to be made by the owners of real estate, or occupants of such real estate, in front of or adjacent to where said improvements are so ordered." There was a further provision that such owners or occupants "shall make or cause to be made said improvements at their own cost and charges," and that in case of their default the council may cause the improvements to be made and assess the expense upon the property. It was not controverted that the statute required that an order should have been made for the adjacent proprietors to make the improvement and opportunity given them to do so before the council could rightfully let a contract for doing it, and it was admitted that this was not done. Whether this contract was *ultra vires*, and whether the municipality should be heard to interpose that defense to an action by the other party to recover upon the contract after it had been performed, were the points considered by the Minnesota Supreme Court. The court held that the contract was unauthorized, and that, not having been misled by any fact, the contractor was not entitled to recover on such contract.[1] The court, after stating the powers of the corporation, and restrictions upon the same, said: "Not only was the party entering into this contract legally chargeable with notice that by the public charter the authority of the council was thus restricted (McDonald *v.* Mayor, 68 N. Y. 23; Schumm *v.* Seymour, 24 N. J. Eq. 143), but the allegation in the complaint that the plaintiff warned the defendant that the contract was void before he commenced to perform it, is admitted by the answer. The doctrine of *ultra vires* has with good reason been applied

[1] Newbery *v.* Fox, (1887) 37 Minn. 141; s. c., 33 N. W. Rep. 333, affirming the sustaining of a demurrer to the answer of defendant.

with greater strictness to municipal bodies than to private corporations, and in general a municipality is not estopped from denying the validity of a contract made by its officers when there has been no authority for making such a contract.[1] A different rule of law would, in effect, vastly enlarge the power of public agents to bind a municipality by contract, not only unauthorized but prohibited by the law. It would tend to nullify the limitations and restrictions imposed with respect to the powers of such agents, and to a dangerous extent expose the public to the very evils and abuses which such limitations are designed to prevent. In the case here presented it is not to be denied that the town council had no authority to make this contract; that the charter set forth the conditions which would authorize such a contract to be made; that those prescribed conditions had not been fulfilled, nor did the defendant believe that they had been. The most that appears in his favor is that, without being misled or mistaken as to the fact, but being warned that the contract was void, he nevertheless judged that it was legally valid; and, being also advised by the members of the council, he took the risk of performing it. The contract being thus unauthorized was not effectual as a contract, and the defendant does not appear in a position entitling him to invoke the doctrine of estoppel to aid him in enforcing the claim as though the contract was obligatory upon the town." The Supreme Court of Colorado has held that the provision of the charter of the city involved declaring that neither the city council nor any officer of the city shall make any contract or do any thing binding or imposing upon the city any liability to pay money as upon contract until a definite appropriation shall be made to meet the requirements or consequences of such contract, was mandatory, and the ditch company furnishing the water for the necessary uses of the city could not recover against the city the reasonable price for the use of the water in the absence of such a definite appropriation.[2]

[1] Citing Mayor *v.* Ray, 19 Wall. 468; Brady *v.* Mayor of New York, 20 N. Y. 312; Hague *v.* City of Philadelphia, 48 Pa. St. 527; 1 Dill. Mun. Corp. 457; Nash *v.* City of St. Paul, 8 Minn. (172).

[2] Smith Canal or Ditch Co. *v.* City of Denver, (Colo. 1894) 36 Pac. Rep. 844. The court referred to the cases of Argenti *v.* City of San Francisco, 16 Cal. 255; Nelson *v.* Mayor, 63 N. Y. 535, quoting from the opinion of FOLGER, J., in the latter, and cited further, McDonald *v.* Mayor, 68 N. Y. 28; Smith *v.* City of Newburgh, 77 N. Y. 130; McCoy *v.* Briant, 53 Cal. 247; People *v.* May, 9 Colo. 80; s. c., 10 Pac. Rep. 641. When one benefited by a contract with a municipality cannot object that it was *ultra vires* the municipality, see City of Buffalo *v.* Balcom, (1892) 134 N. Y. 532; s. c., 32 N. E. Rep. 7.

§ 267. Injunction of public officials — rules.— The Supreme Court of Washington has held in a taxpayer's action against the commissioners of a county, that the taxpayer was entitled to an injunction to restrain them from issuing certain bonds as the debt proposed to be increased was beyond the limitation of indebtedness which the corporation was allowed to incur and had not been properly ratified or validated, and, further, the arrangement with a trust company for the sale of the bonds, by which the latter was to be allowed commissions, etc., of a large amount, violated the requirement of law that they should not sell the bonds below par.[1]

[1] Hunt *v.* Fawcett et al., County Commissioners, (Wash. 1894) 36 Pac. Rep. 318. In Avery *v.* Job, (Ore. 1894) 36 Pac. Rep. 293, the Supreme Court affirmed the granting of an injunction in a taxpayer's suit, restraining the mayor, etc., of the city from purchasing a plant of a waterworks company for $28,000, worth only $10,000, and inadequate and unsuited to the purpose, though the purchase or erection of waterworks was a matter within the discretion of the city council. In Intendant & Town Council of Livingston *v.* Pippin, (1858) 31 Ala. 542, an action against the municipality to recover the price agreed to be paid for the boring of an artesian well, it was held that the municipal corporation could not set up the defense that though its corporate authorities had power to contract for the procuring of a supply of water on the public square of the town, they ought to have adopted some less expensive means of procuring it. The court said: "The corporate authorities, having the power to procure the supply of water, were themselves the judges of the *mode* and *manner* best calculated to accomplish that object. Lawless *v.* Reese, 4 Bibb, 309. The propriety of their election and the binding efficiency of their contract cannot be questioned collaterally. If their proposed expenditure was an abuse of their powers, any of the corporators have an ample remedy by injunction. See Christopher *v.* Mayor of New York, 13 Barb. 567, and authorities cited." For a full discussion of the subject of injunctions against public boards of commissioners, etc., see Stevens *v.* St. Mary's Training School, (1893) 144 Ill. 336. That persons dealing with a municipal corporation through its officers must know and are charged with a knowledge of their powers in contracting, see McDonald *v.* Mayor, etc., of New York, 68 N. Y. 23; Cornell *v.* Guilford, 1 Den. 510; Sutro *v.* Pettit, 74 Cal. 332; Hodges *v.* Buffalo, 2 Den. 110; Lowell Savings Bank *v.* Winchester, 8 Allen, 109; Merchants' Bank *v.* Bergen County, 115 U. S. 384; Wallace *v.* Mayor, etc., of San Jose, 29 Cal. 181; Dorsey County *v.* Whitehead, 47 Ark. 205; Barton *v.* Swepston, 44 Ark. 437; Schumm *v.* Seymour, 24 N. J. Eq. 143; Alton *v.* Mulledy, 21 Ill. 76; Cleveland *v.* State Bank of Ohio, 16 Ohio St. 236; Chicago *v.* Shober, etc., Co., 6 Bradw. (Ill.) 560; Craycraft *v.* Selvage, 10 Bush (Ky.), 708; Perkinson *v.* St. Louis, 4 Mo. App. 322;

Clark *v.* Polk County, 19 Iowa, 248; Carpenter *v.* Union, 58 Iowa, 335; Estep *v.* Keokuk County, 18 Iowa, 199; Whiteside *v.* United States, 93 U. S. 247; Harshman *v.* Bates County, 92 U. S. 569; Maupin *v.* Franklin County, 67 Mo. 327. As to when a municipal corporation is not estopped to set up a plea of *ultra vires* in actions brought upon contracts entered into by its officers, see Sioux City *v.* Weare, 59 Iowa, 95; Stidger *v.* Redoak, 64 Iowa, 465; State *v.* Haskell, 20 Iowa, 276; East Oakland *v.* Skinner, 94 U. S. 255; Post *v.* Kendall County, 105 U. S. 667; McClure *v.* Oxford Township, 94 U. S. 429; Bates County *v.* Winters, 97 U. S. 83; South Ottawa *v.* Perkins, 94 U. S. 260; Daviess County *v.* Dickinson, 117 U. S. 657; Burrill *v.* Boston, 2 Cliff. 590; Fox *v.* New Orleans, 12 La. Ann. 154; Seibrecht *v.* New Orleans, 12 La. Ann. 496; Cheeney *v.* Brookfield, 60 Mo. 53; McCaslin *v.* State, 99 Ind. 428; State *v.* Bevers, 86 N. C. 588; Dill *v.* Wareham, 7 Met. 438; Yancey *v.* Hopkins, 1 Munf. (Va.) 419; Nalle *v.* Fenwick, 4 Rand. (Va.) 585; Shipman *v.* State, 43 Wis. 381; Perry *v.* Superior City, 26 Wis. 64; State *v.* Hastings, 12 Wis. 596; Nash *v.* St. Paul, 8 Minn. 172; Donovan *v.* Mayor, etc., of New York, 33 N. Y. 291; Appleby *v.* Mayor, etc., 15 How. Pr. 428; Martin *v.* Mayor, etc., of Brooklyn, 1 Hill, 545; Albany *v.* Cunliff, 2 N. Y. 165; Overseers of Norwich *v.* Overseers of New Berlin, 18 Johns, 382; Cowen *v.* West Troy, 43 Barb. 48; Trustees of Paris Township *v.* Cherry, 8 Ohio St. 564; Western College of Medicine *v.* Cleveland, 12 Ohio St. 375; Mitchell *v.* Rockland, 41 Me. 363; Fluty *v.* School District, 49 Ark. 94; Halbut *v.* Forrest City, 34 Ark. 246; Mitchell *v.* Rockland, 45 Me. 496; People *v.* Baraga Township, 39 Mich. 554; Taft *v.* Pittsford, 28 Vt. 286; Haynes *v.* Covington, 13 Sm. & Marsh (Miss.), 408; Treadway *v.* Schnauber, 1 Dak. 236; Neely *v.* Yorkville, 10 S. C. 141; Bryan *v.* Page, 51 Tex. 532; Trustees of Belleview *v.* Hohn, 82 Ky. 1; s. c., 4 Am. & Eng. Corp. Cas. 524; Murphy v. Louisville, 9 Bush (Ky.), 189.

CHAPTER VIII.

ULTRA VIRES — PRIVATE CORPORATIONS.

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281. Rules declared by courts as to estoppel of parties to contracts with corporations to plead ultra vires.
282. Financial arrangements contrary to public policy — rules governing proceedings on the part of the state, etc.

§ 268. The doctrine of ultra vires as explained by English courts.— Where a corporation is created by an act of parliament for particular purposes, with special powers, "their deed, under their corporate seal, and that regularly affixed, does not bind them, if it appear by the express provisions of the statute creating the corporation, or by necessary or reasonable inference from its enactments, that the deed was *ultra vires* — that is, that the legislature meant that such a deed should not be made," was stated to be the rule by Baron PARKE.[1] Lord Chancellor CRANWORTH has observed in a case that he thought the statement of the rule by Baron PARKE "the more correct way of enumerating the doctrine, though practically it makes very little difference whether we say that the railway company has no authority given to it by its incorporation to enter into contracts as to matters not connected with its corporate duties, or that it is impliedly pro-

[1] South Yorkshire Railway *v.* Great Northern Railway, 9 Exch. 55, 84. See, also, Scottish Northeastern Railway *v.* Stewart, 3 Macq. 382, 415, by Lord WENSLEYDALE.

hibited from so doing, because by necessary inference the legislature must be considered to have intended that no such contracts should be entered into."[1] Lord St. Leonard has distinctly recognized that "directors cannot act in opposition to the purpose for which their company was incorporated, nor bind their companies by contracts foreign to the purposes for which they were established."[2] Lord Chancellor Cranworth has said that the English authorities had "established the proposition that a railway company cannot devote any part of its funds to an object not within the scope of its original constitution, how beneficial soever that object might seem likely to prove;" and, after a review of the cases reported, "it must, therefore, be now considered as a well-settled doctrine that a company incorporated by act of parliament for a special purpose cannot devote any part of its funds to objects unauthorized by the terms of its incorporation, however desirable such an application may appear to be."[3]

§ 269. These rules applied by English courts to special acts of corporations.—In an English case the objects of the company registered under the English Joint-Stock Companies Act of 1862 was created were stated in its memorandum of association to be "to make and sell or lend or hire railway carriages and wagons and all kinds of railway plant fittings, machinery and rolling stock; to carry on the business of mechanical engineers and general contractors; to purchase, lease, work and sell mines, minerals, land and buildings; to purchase and sell, as merchants, timber, coal, metals or other materials, and to buy and sell any such materials on commission or as agents." The directors agreed to purchase a concession for making a railway in a foreign country, and afterward (on account of difficulties existing by the law of that country) agreed to assign the concession to an association formed there, which was to supply the materials for the construction of the railway and receive periodical payments from the English company. In an action at law brought by the foreign associates against the English company upon this agreement, it was held in the lower courts, as well as in the House of Lords, to be *ultra vires*. The House of Lords unanimously held the contract not to be within the scope of the memorandum of

[1] Shrewsbury & Birmingham Railway *v.* Northwestern Railway, 6 H. L. Cas. 113, 135–137.

[2] Eastern Counties Railway *v.* Hawkes, 5 H. L. Cas. 331.

[3] Ibid.

association and, therefore, void and incapable of being ratified, and that the action could not be maintained.[1] In an English case it was held that no action could be maintained by one railway company against another upon an agreement made by the latter to take a lease of the railway of the first company and to pay the expenses incurred by that company in the soliciting and promoting of bills in parliament for the extension and improvement of that railway, even if the object and effect of the agreement were to increase the profits of the defendants' railway.[2] In a

[1] Ashbury Railway Carriage & Iron Co. *v.* Riche, L. R., 7 H. L. 653; in the lower courts, L. R., 9 Exch. 224. Lord Selborne of the House of Lords said: "The action in this case is brought upon a contract not directly or indirectly to execute any works, but to find capital for a foreign railway company in exchange for shares and bonds of that company. Such a contract, in my opinion, was not authorized by the memorandum of association of the Ashbury Company. All your lordships and all the judges in the courts below appear to be so far agreed. But this, in my judgment, is really decisive of the whole case. * * * I think that contracts for objects and purposes foreign to or inconsistent with the memorandum of association are *ultra vires* of the corporation itself. And it seems to me far more accurate to say that the inability of such companies to make such contracts rests on an original limitation and circumscription of their powers by the law, and for the purposes of their incorporation, than that it depends upon some express or implied prohibition, making acts unlawful which otherwise they would have had a legal capacity to do. This being so, it necessarily follows * * * that where there could be no mandate there cannot be any ratification; and that the assent of all the shareholders can make no difference when a stranger to the corporation is suing the company in its corporate name upon a contract under the common seal. No agreement of shareholders can make that a contract of the corporation which the law says cannot and shall not be so."

[2] East Anglian Railways *v.* Eastern Counties Railway, 11 C. B. 775. It was said by Chief Justice Jervis, in delivering the judgment of himself and Justices Maule, Williams and Talfourd: "This act is a public act accessible to all and supposed to be known to all, and the plaintiffs must, therefore, be presumed to have dealt with the defendants with a full knowledge of their respective rights whatever those rights may be. It is clear that the defendants have a limited authority only and are a corporation only for the purpose of making and maintaining the railway sanctioned by the act; and that their funds can only be applied for the purposes directed and provided for by the statute. Indeed, it is not contended that a company so constituted can engage in new trades not contemplated by their act; but it is said that they may embark in other undertakings, however various, provided the object of the directors be to increase the profits of their own railway. This, in truth, is the same proposition in another form, for if the company cannot carry on a trade merely because it was not contemplated by the act, they cannot embark in other undertakings not

case where a railway company, authorized by act of parliament to purchase a branch line and to raise a sum of money for the purpose of constructing that line, applied part of the sum so raised to the construction of its main line, Vice-Chancellor WIGRAM and Lord Chancellor COTTENHAM, on appeal, sustained the bill of a shareholder, not only to restrain such application of the bill of a shareholder, not only to restrain such application of the rest of the sum, but also for an account of the part already illegally expended.[1]

§ 270. The doctrine of ultra vires as explained by United States courts.— The Supreme Court of the United States has approved the rules established in the English cases, and held that the purchase of a steamboat to run in connection with a railroad corporation's road and the giving of a note for the same, was a departure from the business of the corporation, and that the officers in the purchase and the execution of the note for the purchase money exceeded their authority.[2] Speak-

sanctioned by the act merely because they hope the speculation may ultimately increase the profits of the shareholders. They cannot engage in a new trade because they are a corporation only for the purpose of mak- and maintaining the Eastern Counties Railway. What additional power do they acquire from the fact that the undertaking may in some way benefit their line? Whatever may be their object or the prospect of success, they are still but a corporation for the purpose only of making and maintaining the Eastern Counties Railway; and if they cannot embark in new trades because they have only a limited authority, for the same reason they can do nothing not authorized by their act and not within the scope of their authority. Every proprietor, when he takes shares, has a right to expect that the conditions upon which the act was obtained will be performed; and it is no sufficient answer to a shareholder expecting his dividend that the money has been expended upon undertakings which at some remote period may be highly beneficial to the line. The public also has an interest in the proper administration of the powers conferred by the act. The comfort and safety of the line may be seriously impaired if the money supposed to be necessary and destined by parliament for the maintenance of the railway be expended in other undertakings not contemplated when the act was obtained and not expressly sanctioned by the legislature." See, also, Macgregor *v.* Dover & Deal Railway, 18 Q. B. 618.

[1] Bagshaw v. Eastern Union Railway, 7 Hare, 114; s. c., 2 Macn. & Gord. 389; 2 Hall & Twells, 201. In Caledonian & Dumbartonshire Railway *v.* Magistrates of Helensburgh, 2 Macq. 391, the House of Lords held that no action would lie against a railway company on an agreement of its projectors to advance money to construct a pier and harbor at the end of a proposed branch of the railway.

[2] Pearce *v.* Madison & Indianapolis Railroad, 21 How. 441.

ing of the decision in Ashbury Railway Carriage & Iron Co. *v.* Riche, 7 H. L. 653, as establishing "the broad doctrine that a contract not within the scope of the powers conferred on the corporation cannot be made valid by the assent of every one of the shareholders, nor can it by any partial performance become the foundation of a right of action," Mr. Justice MILLER, of the Supreme Court of the United States, expressed the opinion that that decision "represents the decided preponderance of authority both in this country and in England, and is based upon sound principles."[1] This may be generally stated as settled law with reference to corporations. A corporation has power to do such business only as it is authorized to do, and no other. It is not held out by the government nor by the stockholders as authorized to make contracts which are beyond the purposes and scope of its charter. It is not vested with all the capacities of a natural person, or of an ordinary partnership, but with such only as its charter confers. If it exceeds its chartered powers, not only may the government take away its charter, but those who have subscribed to its stock may avoid any contract made by the corporation in clear excess of its powers. If it makes a contract manifestly beyond the powers conferred by its charter, and, therefore, unlawful, a court of chancery, on the application of a stockholder, will restrain the corporation from carrying out the contract, and a court of common law will sustain no action on the contract against the corporation.[2] The Court of Appeals of Maryland

[1] Thomas *v.* Railroad Co., 101 U. S. 71.

[2] Davis *v.* Old Colony R. R. Co., (1881) 131 Mass. 258. This reference is made to a leading English case: "In the leading case of Colman *v.* Eastern Counties Railway, 10 Beav. 1, the directors of a railway company were restrained by injunction from carrying out an agreement by which, for the purpose of increasing its traffic, they proposed to guarantee certain profits to, and to secure the capital of, a steam packet company, to ply between a port near one end of the railway in England and certain foreign ports, and Lord LANGDALE, M. R., said: 'To look upon a railway company in the light of a common partnership and as subject to no greater vigilance than common partnerships are, would, I think, be greatly to mistake the functions which they perform and the powers which they exercise of interference, not only with the public but with the private rights of all individuals in this realm. We are to look upon those powers as given to them in consideration of a benefit which, notwithstanding all other sacrifices, it is to be presumed and hoped, on the whole, will be obtained by the public. But it being the interest of the public to protect the private rights of all individuals, and to defend them from all liabilities beyond those necessarily oc-

have decided that corporations are not only incapable of making contracts which are forbidden by their charter, but in general they can make none which are not necessary, either directly or indirectly, to effect the objects of their creation, and that the corporation itself may, in an action brought against it upon such contract, deny its power to enter into it.[1] In a New York case, involving the issue of preferred stock by a corporation to certain of its stockholders who advanced money for the purposes of the corporation, FOLGER, J., of the Commission of Appeals, very fully explained this doctrine in words which have been generally approved and accepted as correct by the courts of this country. He said: "In the application of the doctrine of *ultra vires*, it is to be borne in mind that it has two phases, one where the public is concerned; one where the question is between the corporate body and the stockholders in it, or between it and its stockholders and third parties dealing with it and through it

casioned by the powers given by the several acts, those powers must always be carefully looked to, and I am clearly of opinion that the powers which are given by an act of parliament like that now in question, extend no further than is expressly stated in the act, or is necessarily and properly required for carrying into effect the undertaking and works which the act has expressly sanctioned. * * * Ample powers are given for the purpose of constructing and maintaining the railway, and for doing all those things required for its proper use when made, but I apprehend that it has nowhere been stated that a railway company, as such, has power to enter into all sorts of other transactions. Indeed, it has been very properly admitted that railway companies have no right to enter into new trades or businesses not pointed out by their acts; but it has not been contended that they have a right to pledge without limit the funds of the company for the encouragement of other transactions, however various and extensive, provided the object of their liability is to increase the traffic upon the railway and thereby to increase the profit to the shareholders. There is, however, no authority for anything of that kind. It has been stated that these things, to a small extent, have frequently been done since the establishment of railways, but unless the acts so done can be proved to be in conformity with the powers given by the special acts of parliament, under which those acts are done, they furnish no authority whatever.' And after full consideration of the case he summed up his opinion thus: 'To pledge the funds of this company for the purpose of supporting another company engaged in a hazardous speculation, is a thing which, according to the terms of this act of parliament they have not a right to do.' They have the power to do all such things as are necessary and proper for the purpose of carrying out the intention of the act of parliament, and they have no power of doing anything beyond it." See, also, Salomons v. Laing, 12 Beav. 339, 352, 353.

[1] Pennsylvania, Delaware & Maryland Steam Navigation Co. v. Dandridge, 8 Gill & Johns. (Md.) 248.

with them. When the public is concerned, to restrain the corporation within the limits of the power given to it by its charter, an assent by the stockholders to the use of unauthorized power by the corporate body will be of no avail. When it is a question of the right of a stockholder to restrain the corporate body within its express or incidental powers, the right of the stockholder may, in many cases, be denied on the ground of his express assent or his intelligent though tacit consent to the corporate action. If there be a departure from statutory direction, which is to be considered merely a breach of trust to be restrained by a stockholder, it is pertinent to consider what has been his conduct in regard thereto. A corporation may do acts which affect the public to its harm, inasmuch as they are *per se* illegal or are *malum prohibitum*. Then no assent of stockholders can validate them. It may do acts not thus illegal, though there is want of power to do them, which affect only the interest of the stockholders. They may be made good by the assent of the stockholders, so that strangers to the stockholders dealing in good faith with the corporation will be protected in a reliance upon those acts. The instance put in Bissell *v.* Mich. So., etc., R. R. Co., 22 N. Y. 269, is illustrative. A bank has no authority from the state to engage in benevolent enterprises, and a subscription, though formally made, for a charitable object, would be out of its powers, but it would not be otherwise an illegal act, yet, if every stockholder did expressly assent to such an application of the corporate funds, though it would still be in one sense *ultra vires*, no wrong would be done, no public interest harmed, and no stockholder could object or claim that there was an infringement of his rights and have redress or protection. Such an act, though beyond the power given by the charter, unless expressly prohibited, if confirmed by the stockholders, could not be avoided by any of them to the harm of third persons. This arises from the principle that the trust for stockholders is not of a public nature."[1]

§ 271. Illustrations of acts not ultra vires the corporation.— In furtherance of its legitimate objects and in the due prosecution of its business, a corporation may loan money and take mortgage security.[2] If the term for which a corporation is authorized to

[1] Kent *v.* Quicksilver Mining Co., (1879) 78 N. Y. 159, 185, 186.

[2] Madison, etc., Plank Road Co. *v.* Watertown Plank Road Co., 5 Wis. 173.

loan money on mortgage be limited to one year, it may still enforce securities given for a loan of two years, if there is no penalty attached to taking such securities; and it may ratify a loan made without the required vote of its directors.[1] A building and loan association having conferred upon it by the statutes of a state expressly the power to loan money to its shareholders, on mortgages of real estate, on such terms and conditions as may be prescribed by the by-laws, a loan to one of its shareholders, though not strictly in conformity to one of its by-laws, or even contravening it, would not be *ultra vires*.[2] Corporations formed under the general law of California, it has been held, have the power to purchase and hold an exclusive franchise or privilege granted by the legislature to an individual and his assigns.[3] It does not follow from the prohibition in a charter of a corporation of dealing in commercial paper that the corporation may not receive and sell notes given for the sale of its lands.[1] A corporation succeeding to the business of an individual in its line of manufactures, for instance, may accept from the individual whom it succeeded an order accepted by him upon particular terms.[2] Though the articles of an incorporated college may not expressly give it power to raise and control funds by taking endowment notes, it may accept and enforce payment of such notes.[3] A contract entered into by a railroad corporation before the completion of its line of road, for the transportation of freight after the completion of its line, is not *ultra vires*, but is binding and enforceable.[4] And such a corporation, while retaining the benefit of such a contract which has been fully executed, cannot assert that it had no power to make the contract the consideration for which it had received.[5] A railroad corporation, under the statutes of Indiana, may pay in advance for the use of another railroad thus aiding in its construction.[6] It is not beyond the power of a corporation authorized by its charter to purchase "any real estate or other property," etc., to purchase its own stock.[7] In an early Massachusetts case it was held that where a statute of the state prohibited the receiving or negotiating in any way of bills or notes of banks not incorporated in that state, the taking of a note payable in such bills was an act *ultra vires* a Massachusetts banking institution and the

[1] Germantown F. M. Ins. Co. *v.* Dhein, 43 Wis. 420.

[2] Kelly *v.* Mobile Building & Loan Association, (1879) 64 Ala. 501. In Cooper *v.* Frederick, (1846) 9 Ala. 738, it was held that a resolution by the directors of a railroad corporation, that the stockholders might relinquish one-half of their stock and the payments previously made accounted for as if made on the stock retained, provided the stockholders paid all the calls subsequently made by the directory, was in the nature of a contract, entered into between the corporation and its members, and was not on its face illegal and improper.

[3] California State Telegraph Co. *v.* Alta Telegraph Co., (1863), 22 Cal. 398. A purchase by a corporation in the face of a positive prohibition would be void; but that is not this case. There was no provision of law forbidding the purchase; and, admitting that the corporation had no power to make it, the want of power, in the absence of an express prohibition, is not sufficient to avoid it as to third persons. The rule in such cases was laid down by this court in Natoma Water & Mining Co. *v.* Clarkin, 14 Cal. 544. In that case the corporation was empowered to purchase such property as the purposes of the corporation should require, and it was objected that the property in controversy was not of that description, and that the corporation had no power to purchase it. The court overruled the objection, saying: "Whether or not the premises in controversy are necessary for those purposes, it is not material to inquire; that is a matter between the government and the corporation, and is no concern of the defendant." The reason of the rule is obvious. As between the parties the purchase is valid and it must be so as to third persons, until, by a proper proceeding, a forfeiture has been declared. It is well settled that a cause of forfeiture cannot be inquired into collaterally." In his concurring opinion COPE, Ch. J., said: "As to the capacity of the corporation to purchase, the defendant is not the party to object. If the corporation, in making the purchase, has acquired property which, under the law of its incorporation, it had no right to acquire, all that can be said is that it has exceeded its powers, and may be deprived of the property by a judgment of forfeiture. The question is one which the state alone can raise."

[1] Buckley *v.* Briggs, (1860) 30 Mo. 452. In Western Organ Co. *v.* Reddish, 51 Iowa, 55, it was held that the corporation, though organized for the manufacture and sale of musical instruments, with no power to engage in the business of loaning money, might still take from its agent in payment of indebtedness by him to the corporation the note of a third party belonging to him.

[2] Cook Manufacturing Co. *v.* Randall, 62 Iowa 244.

[3] Simpson Centenary College *v.* Bryan, 50 Iowa, 293.

[4] Louisville. New Albany & Chicago Ry. Co. *v.* Flanagan, (1887) 113 Ind. 498.

[5] Ibid.

[6] Aurora & Cincinnati R. Co. *v.* City of Lawrenceburgh, (1877) 56 Ind. 80. As to the right of a corporation to purchase its own stock and reissue it, see City Bank *v.* Bruce, 17 N. Y. 507; C., P. & S. W. R. R. Co. *v.* Marseilles, 84 Ill. 145, 643; L. S. I. Co. *v.* Drexel, 90 N. Y. 93; State Bank *v.* Fox, 3 Blatchf. 434; Otter *v.* Brevoort P. Co., 50 Barb. 256. As to the power of a corporation to purchase shares of its own stock in good faith, and not in fraud of its creditors, see Chicago, Pekin & So. Western R. R. Co. *v.* President, etc., Town of Marseilles, (1876) 84 Ill. 145; on rehearing, 84 Ill. 643; Clapp *v.* Peterson, (1882), 104 Ill. 26.

[7] Iowa Lumber Co. *v.* Foster, 49 Iowa, 25.

note was void.[1] A manufacturing corporation may take shares of another corporation in payment of a debt.[2] An academy being incorporated for the purpose of holding funds to be applied to the education and moral and religious improvement of youth, its trustees are capable of holding funds in trust for an association the objects of which are similar and to any extent auxiliary to those for which they may have been incorporated.[3] A corporation vested with power to take and dispose of the securities of another corporation may guarantee the payment of those securities if it disposes of them to another party in payment of its own debt. So, too, if it buys property subject to a mortgage security bond, it may guarantee the payment of such bonds if the guaranty be taken as payment *pro tanto* of its debt.[4] A corporation created for the purpose of constructing a road, empowered by statute to borrow money to be used in the construction of its road or in paying for materials purchased for its construction and to mortgage its road to secure the payment of the money so borrowed, may mortgage its road to secure the payment of money due a contractor for constructing the same; and it may mortgage any portion of its road as well as the whole of it.[5] Such a corporation, the charter of which authorizes it to borrow money "on such terms as might be agreed upon between the parties," may borrow money at a rate of interest beyond that established by the general law.[6] An insurance corporation authorized to invest its capital, profits and surplus funds in such securities, and in such manner as it may elect, and required to invest its reinsurance fund among other securities, in "bonds and mortgages on unincumbered real estate," will not commit an act *ultra vires* by making a loan of money to one, accepting his notes and mortgage to secure them.[1] The charter of a Massachusetts corporation authorized it to purchase and hold "in fee simple or otherwise" real and personal estate to the amount of $50,000, which was increased by subsequent statutes to $600,000. The corporation was also by its charter authorized to appropriate its funds to charitable purposes, and to employ its annual income, among other purposes, "to promote inventions and improvements in the mechanic arts, by granting premiums for said inventions and improvements." There was no direction in the charter or subsequent statutes as to the manner in which the provisions for granting these premiums should be carried out. It was held by the Supreme Court of Judicature that the corporation might purchase land and erect a permanent building thereon in which to hold exhibitions and the meetings of the corporation.[2]

[1] President, Directors, etc., of Springfield Bank *v.* Merrick, (1817) 14 Mass. 322.

[2] Howe *v.* Boston Carpet Co., (1860) 16 Gray, 493; citing Hodges *v.* New England Screw Co., 1 R. I. 312, and 3 R. I. 9; Treadwell *v.* Salisbury Mfg. Co., 7 Gray, 393.

[3] Phillips Academy *v.* King (1815), 12 Mass. 546.

[4] Ellerman *v.* Chicago Junction Railway & Union Stock Yards Company, (1891), 49 N. J. Eq. 217. In Willoughby *v.* Chicago Junction Railways & Union Stock Yards Company, (1892) 50 N. J. Eq. 656, the defendant corporation being authorized by charter to issue bonds for proper corporate purposes, and the validity of the contract being established, the Court of Chancery declined to interfere to regulate the character of the payments, or of the instruments to be issued therefor, as long as the same were not expressly unauthorized.

[5] Greensburgh, Milford & Hope Turnpike Co. *v.* McCormick, (1873) 45 Ind. 239.

[6] Morrison *v.* Eaton & Hamilton R. R. Co. (1860) 14 Ind. 110.

[1] Daly *v.* National Life Insurance Co., (1878) 64 Ind. 1.

[2] Richardson *v.* Massachusetts Charitable Mechanic Association, (1881) 131 Mass. 174. It was said by the court: "For many years the association has been in the habit of holding such exhibitions in buildings hired or temporarily erected for that purpose. The money received from such exhibitions, over and above the expenses, has been invested in real and personal estate, and the income therefrom devoted to the use of the association as directed by the charter. We cannot say that the method thus adopted for carrying into execution this particular provision of the charter is beyond the power of the corporation. The charter failing to indicate in what manner this power shall be exercised, a wide discretion is given to the association; for there are many ways in which it might be executed. An exhibition open to the public at a proper charge, at which mechanics may display their inventions and improvements, and compete for premiums and gratuities, would seem to be a reasonable method for carrying out this provision, not inconsistent with any other provision of the charter; and any profit arising therefrom might properly be held by the association and the income thereof devoted to the purposes for which it was incorporated. In order to do this, a place must be provided for the exhibition, either by hiring buildings, or by erecting temporary or permanent buildings for the purpose, for the association has full power to acquire title to real estate in fee simple or otherwise, and it can undoubtedly hold such real estate as is necessary for its use in the exercise of the powers conferred upon it." In Seymour *v.* Spring Forest Cemetery Association, (1892) 64 Hun, 632; s. c., 19 N. Y. Supp. 94, the bonds given by the association for lands purchased under the powers granted such associations by statute to "purchase such real estate as the purposes of the association may require" were held not to be void as *ultra vires*. See Fuld *v.* Burr Brewing Co., (Ct. Com. Pl. N. Y. City, 1892) 18 N. Y. Supp. 456, for an illustration of what guaranty was

Where a railroad corporation agreed to load steamers chartered by a cotton compress company with cotton on terms named in their contract for shipment, and the compress company had, by the delay of the railroad corporation in delivering the cotton for shipment, to pay a large sum for demurrage and brought its action against the railroad corporation for its recovery, the Court of Appeals of Virginia held that the contract on the part of the railroad corporation was not *ultra vires*.[1] A loan of money upon mortgage security by a corporation organized for the purpose of constructing ditches for the conveyance and sale of water, the California Supreme Court has held, was not necessarily an act exceeding its corporate powers; further, such a contract, if necessary to attain its general objects and made as an incident to the exercise of its granted powers, was valid, and in the absence of proof it would be presumed.[2] A corporation, organized under

not *ultra vires* this corporation, and, if so, the plea of *ultra vires* was not available, in which case Schurr *v.* Investment Co., (Ct. Com. Pl. N. Y. City, 1892) 18 N. Y. Supp. 454, was distinguished. Illustration of a contract not *ultra vires* the corporation, see United Lines Telegraph Co. *v.* Safe Deposit & Trust Co., (1893) 147 U. S. 431; s. c., 13 Sup. Ct. Rep. 396. What class of contract by a railroad corporation is not *ultra vires*, see Union Pacific Ry. Co. *v.* Chicago, R. I. & P. Ry. Co., (1892) 51 Fed. Rep. 309; s. c., 2 C. C. A. 174; 10 U. S. App. 98.

[1] Norfolk & Western R. R. Co. *v.* Shippers' Compress Co., (1887) 83 Va. 272; s. c., 2 S. E. Rep. 139. The court said: "The contract was incident to and for the benefit of their business as common carriers, and it was but a part of a long-established and systematic policy of these railroads composing the air lines to induce and control the transportation of cotton for the interior west and southwest over their line for shipment to England from the port of New York. It was not a contract to buy or sell cotton, but simply to deliver a certain number of bales of cotton, at a specified time, at Norfolk, for shipment to Liverpool by chartered steamers for that purpose. It was not contrary to or forbidden by their charter, and it was for the interests of commerce and in the line of their business." Citing additionally, as authority, 1 Wood Ry. Law, § 170, pp. 474, 479, 480, 523; §§ 179, 182; Pierce on Railroads, 499–501, 508–510.

[2] Union Water Co. *v.* Murphy's Flat Fluming Co., (1863) 22 Cal. 621. "For instance," said the court, "it might be necessary for such a corporation to make advances, in the nature of a loan, to enable a contractor to construct their works, or it might be very necessary for such a corporation to procure an additional supply of water, and a loan of money to another water company who may be engaged in constructing ditches which will bring such additional supply, may be the direct and necessary means to attain that object. So, too, it might become necessary for a corporation engaged in a large enterprise, such as the construction of large canals, railroads, turnpike roads, and the like, to borrow money on favorable terms and at a low rate of interest; it might be necessary to borrow it upon long time, providing a sinking fund for its payment, by setting apart a certain portion of the corporate revenues, to be loaned out on interest, suffering the principal and interest to accumulate to an amount sufficient to repay the borrowed money when due. Such is the usual mode of conducting the business of corporations of that character, and there can be no objection to it so long as the legitimate business of the corporation is not changed into that of a loan company. So long as the loans are a mere incident to the exercise of its legitimate powers they are rightful and valid. So numerous other cases of a like character might be suggested where loans by a corporation might be very proper and necessary in conducting its business operations; and if all corporations are to be considered as absolutely prohibited, or not permitted, to make any loan of money except in the few classes of cases of corporations where it is expressly allowed by the statute, and all such contracts are to be held void, a result would be produced which certainly never was intended by the legislature, nor is it sustained by the rules of law. A corporation had power to insure lives and grant annuities, and it was held that, as it must have funds to apply to those purposes, it might loan its money, and the loan by it would be presumed to have been made in the ordinary course of its business, and, therefore, valid, although it had no express power to loan money. The authority to loan money was upheld as an incident to the other powers conferred by the charter. Farmers' L. & T. Co. *v.* Clowes, 4 Edw. Ch. 575; s. c., 3 Comst. 470; Farmers' L. & T. Co. *v.* Perry, 3 Sandf. Ch. 339. So, too, an insurance company was incorporated without any special provision in relation to the mode of investing its capital, and it was held that it had the power to invest the whole or any part of its capital by way of loans on bond and mortgage and to reinvest it in the same way whenever it should become necessary or convenient to do so. Mann *v.* Eckford, 15 Wend. 512. Where a bank was authorized to take mortgages in security for debts previously contracted, it was held that if the loan and mortgage were concurrent acts it was not a violation of the restraining clause of the statute. Silver Lake Bank *v.* North, 4 Johns. Ch. 370; Baird *v.* Bank of Washington, 11 Serg. & R. 411. A plankroad company was not authorized to loan money, but if necessary it can legally loan a sum of money to one of its contractors to enable him to build a portion of its road. Madison, etc., Plank Road Co. *v.* Watertown Plank Road Co., 5 Wis. 173. A corporation was prohibited from dealing in goods, wares and merchandise. Held, that a loan made, secured by a quantity of cotton, which was to be shipped and sold and the proceeds credited to the debtor on the loan, was not a violation of the charter. Bates *v.* State Bank, 2 Ala. 465. So, too, a sale by a bank of a quantity of butter which it had taken in settlement of a debt was deemed no violation of a similar clause in its charter. Sacketts Harbor

the laws of Illinois, through its stockholders and officers entered into an agreement with other persons owning patents, etc., adapted to its business, by which a new corporation was organized, the former as a part of its agreement transferring to the new one 10,000 of its shares of stock, which had been prop-

erly set apart for sale for making capital, to be used by the new corporation in the same manner. In an action against one who had purchased 500 shares of this stock, upon his notes given for the same, his plea was that it was an overissue of the stock of the corporation. This point was ruled against the defendant by the Appellate Court of Missouri, and at the same time the court considered the question whether such an agreement, when ratified by the stockholders of the old company and carried out by delivery of the stock to the new company, was repugnant to the laws of the state of Illinois. The court said: "Our examination of the Illinois decisions has led us to the opinion that this contract or arrangement was not *ultra vires* under the law of that state. There are numerous cases of the Supreme Court of that state which hold that a corporation may purchase its own stock and violate no duty to its own stockholders. Chetlain *v.* Ins. Co., 86 Ill. 220; Chicago, etc., Railroad Co. *v.* President, 84 Ill. 145. In the Chetlain case the court held that if A subscribed for ten shares of the capital stock of a corporation, and, having paid two hundred dollars, was willing to receive a certificate for two shares of one hundred dollars each and cancel his subscription for the ten shares, this could be done, and that the other eight shares would belong to the company, and that it had a right to sell them to whom it pleased. The doctrine of this case would indicate that the agreement to donate the ten thousand shares was invalid, and when ratified by the stockholders of the old company it vested in the new corporation the title to the stock and the company had the right to sell it to whom they pleased. * * * There is no principle of law known to us which would release the defendant from his liability to pay these notes. No question of fraud or misrepresentation is urged; in fact, the record shows that the plan of incorporation, and especially the plan adopted for the sale of the stock, was devised by the defendant himself. He was an officer and director of the corporation and took an active part in the management of its business, and he is, therefore, in no position to claim that he was overreached or in any way deceived

Bank *v.* Lewis County Bank, 11 Barb. 213. A glass company, not authorized to sell goods generally, sold goods to one in their service, and it was held that the legislature did not intend to prohibit a supply of goods to those employed in the manufactory, and that the corporation might recover for them. Chester Glass Co. *v.* Dewey, 16 Mass. 102."

in the purchase of the stock or in the execution of the notes."[1] In a Kansas case the Supreme Court held that a contract entered into by a town company incorporated "for the purchase of land, the surveying and platting of town sites and selling town lots and other lands," in which it was agreed that if a certain party would remove a bank, a barn and a restaurant located elsewhere to the town site, the town company would convey to him certain lots in the town and pay him the sum of $1,000, tended directly to enhance the value of the remaining property of the corporation, and was not necessarily *ultra vires*.[2] A contractor for construction of a railroad in Wisconsin was stopped from his work with

[1] Eggmann *v.* Blanke, (1890) 40 Mo. App. 318.

[2] Sherman Center Town Company *v.* Russell, (1891) 46 Kans. 382; s. c., 26 Pac. Rep. 715. *Arguendo*, the court said, upon the insistment that the contract was *ultra vires:* "The corporation may exercise not only the powers expressly enumerated in its charter, if they are authorized by law, but 'may enter into any obligation or contract essential to the exercise of the powers expressly enumerated.' Gen. Stat. of 1889, ¶ 1167. The company is not restricted to the mere purchase and sale of lots, but may doubtless enter into contracts which would directly tend to promote the prosperity of the town, and enhance the value of the lots remaining unsold. To this end it may expend money for the advertising of the property, the making of improvements on a part of the same, may contract for the erection of school buildings and other improvements, the direct and proximate tendency of which will be to attract people to the town and make the property of the company more desirable and salable. The location of [this party] with his bank, his barn and restaurant at the town of Sherman Center no doubt tended directly and proximately to build up the town and give it prestige in that community, thus enhancing the value of the remaining lots and promoting the legitimate objects of the corporation. In Whetstone *v.* Ottawa University, 13 Kans. 320, the question arose whether the Ottawa Town Company could donate the property of the corporation to the Ottawa University for the purpose of erecting a school building outside of the limits of the town of Ottawa, and more than one-fourth of a mile outside of the limits of the property and the land owned by the town company. Mr. Justice BREWER, who pronounced the judgment of the court, remarked that 'Town-site companies are neither novel nor rare in Kansas. Every county has been the home of several, and the manner of their working, and the means employed to accomplish their purposes, are familiar to us all. Nor is Kansas peculiar in this respect. Every western state is full of them. They are private corporations, organized for the purposes of gain. They take real estate, lay it off in lots and blocks, streets and alleys, induce people to settle and purchase, and by the sale of lots make their profits. * * * If by the donation of one lot they can double the value of the remainder, is not the one lot used directly to accomplish the legitimate object of the corporation? If by donating one hundred lots to the county they can secure

the company largely in debt to him. He brought action and obtained judgment. Execution had been returned *nulla bona*. This company had had a benefit of a grant of land. Another company had, through its sole ownership of the stock and by improper practices, managed to have the whole of the property of the indebted company transferred to itself. The United States Supreme Court upheld the suit of representatives of the judgment creditors against this other company to enforce the payment against the transferred property, holding that a sole stockholder in a corporation could not secure the transfer to itself of all the property of the corporation so as to deprive a creditor of the corporation of the payment of his debt.[1] It appeared in a Massachusetts case that a mutual benefit order deposited money with a trust company, which trust company became thereafter unable to repay it. The benefit order assigned the fund to another in terms to secure a promissory note given for a loan, the money obtained by the loan being disbursed in the usual course of its business. The Supreme Judicial Court of that state held that, as the effect of the assignment of the fund was to secure the debt, it was not *ultra vires* even if conceded that the benefit order could not legally make a promissory note. Further, the loan, to secure which the assignment of the fund was given, having been authorized at a meeting of the order and the money obtained used for its benefit, equity would not, at the instance of the receiver of the insolvent trust company, the depositary of the fund, forbid its payment to the assignee out of money in his hands on the ground that the officers executing the assignment had no authority to do so.[2]

the county seat and the erection of county buildings, are they not furthering the very purpose of building up a town? * * * The purpose of securing improvements on the town site is not simply that the improvements be there, but that thereby the property the corporation has to sell may be enhanced in value. And if the lots were donated to secure the erection of a hospital or school at a remote place, as suggested by counsel, there would be no resultant benefit to the corporation of enhanced value of its unsold lots. It seems to us that this must be the test: If the direct and proximate tendency of the improvements sought to be obtained by the donation is the building up of the town and the enhanced value of the remaining property of the corporation, the donation is not *ultra vires*.'"

[1] Angle *v.* Chicago, St. Paul, Minneapolis & Omaha Ry. Co., (1894) 151 U. S. 1.

[2] Commonwealth *v.* Suffolk Trust Co., (Mass. 1894) 37 N. E. Rep. 757.

§ 272. Illustrations of acts ultra vires the corporation.— A corporation confined by its charter to one business cannot lawfully engage in enterprises foreign to that business. For instance, a railroad corporation, the purposes of which are strictly confined to the completion and maintaining of a railroad, cannot lawfully engage in banking.[1] Neither can a corporation engaged in insuring property.[2] While a railroad corporation may adopt any convenient means, proper in themselves, tending directly to the execution of the powers conferred upon it by its charter, and not amounting to the transaction of any distinct unauthorized business,[3] it cannot engage in such business as banking, manufacturing, speculating in land, or the like, as a means of raising funds to build or operate its road.[4] A provision in the charter of an insurance corporation authorizing it to receive money on deposit, "and to give acknowledgments for deposits in such manner and form as they may deem convenient and necessary to transact such business," has been held not to authorize the corporation to issue certificates of deposit to circulate as money, and with the intent that they shall so circulate.[5] A railroad corporation, chartered for the specific purpose of constructing a railroad from one point within the state to the state line, and then to connect with a railroad corporation of that other state, with no express power to execute bills and notes, is limited to executing such bills or notes to such as may be necessary or proper in carrying through that undertaking. It cannot execute accommodation paper, or paper to aid any undertaking not contemplated by its charter; and such

[1] People *v.* River Raisin & Lake Erie R. R. Co., (1864) 12 Mich. 389.

[2] Blair *v.* Perpetual Insurance Co., (1847) 10 Mo. 559.

[3] Clark *v.* Farrington, 11 Wis. 306.

[4] Waldo *v.* Chicago, St. Paul & Fond du Lac R. R. Co., 14 Wis. 575.

[5] Bliss *v.* Anderson, (1858) 31 Ala. 612. The court said: "The corporation may issue its certificates of deposit in any manner and form which will accomplish its business of a depository, but not in such manner and form as will accomplish that and another business. If it can so fashion its certificates of deposit as to procure for them a circulation as money, it can add to its granted powers by an ingenious device, and obtain by subterfuge an authority which legislative caution withheld from it." In Philadelphia Loan Co. *v.* Towner, (1839) 13 Conn. 249, a provision of the charter of the corporation that "nothing therein contained should be construed to authorize the company to discount notes or exercise any banking privileges," was held to prohibit the taking of a note for the sum loaned, and the securing of the interest on that sum in advance, for the period of the loan, and that there could be no recovery on a note thus discounted.

paper, if executed, would be void in the hands of an assignee.[1] Neither a railroad corporation organized under the laws of, or chartered in Massachusetts, nor a corporation organized under the statutes of that state for the manufacture and sale of musical instruments, has power to guarantee the payment of expenses of a musical festival; and no action can be maintained upon such a contract of guaranty, though it may be made with the reasonable belief that the holding of such a festival would be of great benefit to the corporations by increasing their proper business.[2] Though corporations created for the purpose of carrying on a manufacturing business have implied power to make negotiable paper for use within the scope of their business, they have no power to become parties to bills or notes for the accommodation of others.[3] It is not within the powers of a manufacturing corporation, limited by its charter in the use of mercantile paper to that necessary for the convenient prosecution of its business, to accept paper drawn by third parties for accommodation.[4] A contract by which a railroad corporation undertook to grant the exclusive right to construct and maintain a telegraph line along its road to a single telegraph company, has been held in the United States Circuit Court for the district of Washington to be *ultra vires* and void.[5]

[1] Smead *v.* Indianapolis, Pittsburgh & Cleveland R. R. Co., (1858) 11 Ind. 104. In Abbott *v.* Baltimore & Rappahannock Steam Packet Co., (1850) 1 Md. Ch. 542, the object of the corporation, as stated in its charter, was "for the purpose of establishing and conducting a line of steamboats and stages or carriages between Baltimore and Fredericksburg, and the several ports and places on the Rappahannock, and on the rivers and waters of the Chesapeake bay, for the conveyance of passengers and transportation of merchandise and other articles." The High Court of Chancery of Maryland held that it was beyond the power of this corporation to enter into an obligation to aid in an improvement, the purpose of which was to open the Rappahannock river, and render it navigable to the basin in or near Fredericksburg.

[2] Davis *v.* Old Colony R. R. Co., (1881) 131 Mass. 258; Davis *v.* American Organ Co., (1881) 131 Mass. 258.

[3] National Bank of Republic of New York *v.* Young, Receiver of Joseph Dixon Crucible Co., (1886) 41 N. J. Eq. 531; s. c., 7 Atl. Rep. 488; citing 1 Dan. Neg. Inst. §§ 382, 386; Green's Brice's Ultra Vires, 255, 272.

[4] Webster *v.* Howe Machine Co., (1886) 54 Conn. 394; s. c., 8 Atl. Rep. 482.

[5] Pacific Postal Telegraph Cable Co. *v.* Western Union Telegraph Co., (1892) 50 Fed. Rep. 493. HANFORD, D. J., gave as a reason for this ruling "that the laws of the territory of Washington in force when [the contract] was made, did not authorize a railway corporation to transfer land acquired for railroad purposes by lease, so as to divest itself of its duties and obligations to the public as to the use of such. By the plaintiff's own showing it appears that [the railway company] was incorporated to do a general transportation business by rail, and to be a competitor for interstate and international commerce. Its franchise from the state, therefore, made it to a certain extent a public agent endowed with part of the sovereign power of the commonwealth, and a railroad constructed in this state by a corporation organized under the laws of the state or its predecessor, the territory, must necessarily be a highway for public use, in and to which the public have rights limited and regulated by law. There is no statute authorizing such a transfer of property in the right of way and control thereof as the plaintiff now claims was made to it by such contract, and, without express authority conferred by a statute, no transfer of such property or of the right to control the same, could be made whereby the rights of the public, or a third party, *e. g.*, the Western Union Telegraph Company, could be in any manner abridged." Citing Lakin *v.* Willamette Valley, etc., R. R. Co., 13 Or. 436; s. c., 11 Pac. Rep. 68; Braslin *v.* Somerville Horse R. R. Co., 145 Mass. 64; s. c., 13 N. E. Rep. 65; Palmer *v.* Railway Co., (Idaho) 16 Pac. Rep. 553; Railroad Co. *v.* Brown, 17 Wall. 445; Railroad Co. *v.* Crane, 113 U. S. 433, 434; s. c., 5 Sup. Ct. Rep. 578; Oregon Railroad & Navigation Co. *v.* Oregonian Co., 130 U. S. 1; s. c., 9 Sup. Ct. Rep. 409; Van Dresser *v.* Navigation Co., 48 Fed. Rep. 202; U. S. *v.* Western Union Tel. Co., 50 Fed. Rep. 28. That contracts beyond the power of a corporation to make cannot be made binding by a ratification, see Brady *v.* Mayor, etc., of New York, (1859) 20 N. Y. 312. Case holding a contract of sale of the property of a corporation to a foreign corporation, organized through its procurement, for the purpose of taking its place and its assets and carrying on its business *ultra vires:* People *v.* Ballard, (1892) 134 N. Y. 269; s. c., 32 N. E. Rep. 54, reversing People *v.* Ballard, 56 Hun, 125.

The New York Court of Appeals has held that while a corporation organized under the Manufacturing Act of that state has the general power to bind itself by promissory notes and contracts of indorsement made in the usual course of business, it has no power to indorse notes for the accommodation of the maker for a consideration paid.[1] The court, in its opinion, said: "It is well settled that such a power is not incidental to the powers expressly conferred on corporations organized under statutes authorizing the formation of corporations for banking, insuring, manufacturing and like business corporations."[2] A contract by which a street

[1] National Park Bank of New York *v.* German-American Mutual Warehousing & Security Co., (1889) 116 N Y. 281, reversing Same *v.* Same, 21 J. & S. 367.

[2] Citing Central Bank *v.* Empire Stone Dressing Co., 26 Barb. 23; Bridgeport City Bank *v.* Empire Stone Dressing Co., 30 Barb. 421; Farmers & Mechanics' Bank *v.* Empire Stone Dressing Co., 5 Bosw. 275; Morford *v.* Farmers' Bank of Saratoga, 26 Barb. 568; Bank of Genesee *v.* Patchin Bank, 13 N. Y. 309; Ætna National Bank *v.* Charter Oak Life Ins. Co., 50 Conn. 167; Monument National Bank *v.* Globe Works, 101 Mass. 57; Davis *v.* Old Colony R. R. Co., 131 Mass. 258;

railway corporation transferred the entire control of its road with all its franchises, receiving in return only a fixed rent paid in the form of a dividend to its stockholders, has been held to be *ultra vires* and void.[1] A firm of commission merchants and members of the Cotton Exchange of New York received from the cashier of a Texas savings bank and trust corporation, orders to purchase cotton — dealing in futures as it is known — on account of customers of the bank. They made such purchases, and there being a loss in the end, brought their action against the Texas corporation for the amount. The New York Court of Appeals held the transaction to be *ultra vires* the corporation.[2] There

Culver *v.* Reno Real Estate Co., 91 Pa. St. 367; Hall *v.* Auburn Turnpike Co., 27 Cal. 255. As to a manufacturing corporation discounting a note, see Lawrenceville Cement Co. *v.* Parker, (1890) 10 N. Y. Supp. 831.

[1] Middlesex R. R. Co. *v.* Boston & Chelsea R. R. Co., (1874) 115 Mass. 347; citing Richardson *v.* Sibley, 11 Allen, 65.

[2] Jemison *v.* Citizens' Savings Bank of Jefferson, Texas, (1890) 122 N. Y. 135. In the opinion it was said: "Corporations are artificial creations existing by virtue of some statute and organized for the purposes defined in their charters. A person dealing with a corporation is chargeable with notice of its powers and the purposes for which it is formed, and when dealing with its agents or officers is bound to know the extent of their power and authority. A corporation necessarily carries its charter wherever it goes, for that is the law of its existence. It follows that the plaintiffs must have known or are chargeable with knowledge of the corporate powers of the defendant and of the extent to which its cashier could bind the corporation. Alexander *v.* Cauldwell, 83 N. Y. 480; Hoyt *v.* Thompson, 19 N. Y. 207–222; Relfe *v.* Rundle, 103 U. S. 222–226; Davis *v.* Old Colony R. R. Co., 131 Mass. 258–260; Leonard *v.* A. Ins. Co., 97 Ind. 299. Savings banks are designed to encourage economy and frugality among persons of small means and are organized with restrictions and provisions intended to secure depositors against loss. Speculative contracts entered into for the sale or purchase of stock by a savings bank at the stock board or elsewhere, subject to the hazard and contingency of gain or loss, are *ultra vires*, and a perversion of the powers conferred by its charter. People, etc., *v.* M. & T. S. Inst., 92 N. Y. 7–9; Sistare *v.* Best, 88 N. Y. 527–531. Contracts of corporations are *ultra vires* when they involve adventures or undertakings outside and not within the scope or power given by their charters. The acts under which they are organized were framed in view of the rights of the public and the interest of the stockholders. As artificial creations they possess only the powers with which they were endowed. An act may be *malum in se* or *malum prohibitum*, or an act may not be immoral or prohibited by any statute, and still it may be in excess of the powers vested in the officers of a corporation, unauthorized and prejudicial to the stockholders. In either case the plea of *ultra vires* should prevail unless it would defeat justice or accomplish a legal wrong." The court then applied the principles to the case at bar: "As we have seen, the defendant was chartered for the purpose of receiving on deposit or in trust such sums of money as may from time to time be offered by tradesmen, merchants, clerks, laborers, servants and others. It was authorized to loan these moneys according to the Constitution and laws of the state and to discount in accordance with bank usages, taking such security therefor, either real or personal, as the directors may deem sufficient. In addition thereto the defendant was given power to borrow money, buy and sell exchange, bullion, bank notes, government stocks and other securities. The authority here given to buy and sell exchange, bullion, bank notes, government stocks and other securities does not embrace or include speculative contracts in cotton futures any more than it does hay, oats, provisions or dry goods. The exchange, bullion, bank notes, securities, etc., authorized are those of fixed value, current in the market and not subject to the control of speculators. Whilst the buying and selling of cotton to be delivered in the future may not ordinarily be immoral or prohibited by any statute, it is not included in the powers given to the defendant by its charter. The transaction in question was prejudicial to its stockholders and tended to endanger and destroy the safeguards provided for the depositors. The stockholders and depositors had the right to have their funds invested in accordance with the provisions of the charter and the Constitution and laws of the state, and in so far as this right was violated by the transaction in question it was a misappropriation of the funds and immoral."

was a contention in this case that the contract had been executed on the part of the plaintiffs, and that the corporation was estopped from setting up the defense of *ultra vires*. The Court of Appeals held, however, that, under the circumstances of this case, the defense was still available to the corporation.[1]

[1] Jemison *v.* Citizens' Savings Bank of Jefferson, Texas, (1890) 122 N. Y. 135. The court reviewed leading cases pertinent to this question, saying: "In the case of Whitney Arms Co. *v.* Barlow, 63 N. Y. 62, the plaintiff was a corporation organized for the purpose of manufacturing every variety of firearms and other implements of war, and all kinds of machinery adapted to the construction thereof. It entered into a contract with the American Seal Lock Company to manufacture and deliver ten thousand locks. The locks having been delivered, it was held that the contract was fully executed, and the plea of *ultra vires* would not prevail as a defense to an action brought to recover the contract price." Citing Huntington *v.* Savings Bank, 96 U. S. 388; Thomas *v.* R. R. Co., 101 U. S. 71; Nassau Bank *v.* Jones, 95 N. Y. 115; Leslie *v.* Lorillard, 110 N. Y. 519. The court said further: "We do not question the rule thus invoked. It has been repeatedly declared in other cases, as, for instance, in Parish *v.* Wheeler, 22 N. Y. 494, in which it was held that a railroad company having purchased and received a steamboat, could be compelled to pay for it, although the power to purchase such boat was not included in its charter. But this doctrine has no application to executory contracts which are sought to be made the foundation of an action, or to contracts that are prohibited as against public policy or immoral. Nassau Bank *v.* Jones, *supra*; P. C. & S. L. R. Co. *v.* K. & H. B. Co., 131 U. S. 371–389. In the case at

In an Iowa case it was held that it was *ultra vires* a corporation organized under articles of incorporation which defined its business to be "the general freight and transfer business, and such other business as may not be inconsistent therewith," to become surety on a bond given to another corporation.[1] The court also held that the contract of suretyship being utterly void there was no estoppel of the corporation to plead *ultra vires* as to the undertaking.[2]

bar, the transaction, as we have seen, was not only immoral and in violation of the rights of the stockholders and depositors, but the defendant had received nothing by virtue of it. The cotton had been purchased by the plaintiffs in their own name, they taking title thereto and holding it upon the defendant's account. It was purchased under the rules of the Cotton Exchange of the city of New York, in which the members doing business therein, with other members, act as principals and are liable as such. The most that can be claimed is that they held the cotton, or the contracts therefor, subject to the call or order of the defendant. There had been no delivery of any cotton or property of any kind, or transfer of any title to such property to the defendant. If the steamboat had never been delivered to the railroad company so as to transfer the title thereto, or if the ten thousand locks had never been delivered to the American Seal Lock Company, very different questions would have been presented in the cases to which we have called attention. We, consequently, are of the opinion that under the circumstances of this case, the defense of *ultra vires* is still available to the defendant."

[1] Lucas *v.* White Line Transfer Co., (1886) 70 Iowa, 541; s. c., 30 N. W. Rep. 771. The court, through Rothrock, J., said: "The simple act of giving security for another is out of the line of the prosecution of any business. It is a mere accommodation, and it cannot be assumed that the articles gave the officers of defendant any power to jeopardize its capital in any such venture," and quotes as follows: "It is no part of the ordinary business of commercial corporations, and *a fortiori* still less, of non-commercial corporations, to become surety for others. Under ordinary circumstances, without positive authority in this behalf in the grant of corporate power, all engagements of this description are *ultra vires*, whether in the indirect form of going on accommodation bills or otherwise becoming liable for the debts of others. Green's Brice Ultra Vires, 252; Madison, etc., Plank Road Co. *v.* Waterman, etc., Plank Road Co., 5 Wis. 59."

[2] Lucas *v.* White Line Transfer Co., (1886) 70 Iowa, 541; s. c., 30 N. W. Rep. 771. This holding was reached by the application of the following rules, as stated by Rothrock, J., to the case: "(1) Every person dealing with a corporation is charged with knowledge of its powers, as set out in its recorded articles of incorporation. (2) Where a corporation exercises powers not given by its charter, it violates the law of its organization, and may be proceeded against by the state, through its attorney-general, as provided by the statute, and the unanimous consent of all the stockholders cannot make illegal acts valid. The state has the right to interfere in such case. (3) Where a third party makes

§ 273. Leasing corporation's property and franchises for a term of years.— The Indiana Supreme Court has held that a lease of its road by a railway corporation of that state for a long term of years, with the privilege of renewal of the same, to another corporation of the same kind in consideration of the latter

with the officers of a corporation an illegal contract beyond the powers of the corporation, as shown by its charter, such third party cannot recover, because he acts with knowledge that the officers have exceeded their power, and between him and another corporation, or its stockholders, no amount of ratification by those authorized to make the contract will make it valid. (4) Where the officers of a corporation make a contract with third parties in regard to matters apparently within their corporate powers, but which, upon the proof of extrinsic facts (of which such parties had no notice), lie beyond their powers, the corporation must be held, unless it may avoid liability by taking timely steps to prevent loss or damage to such third party; for in such cases the third party is innocent, and the corporation stockholders less innocent, for having selected officers not worthy of the trust reposed in them. (5) This class of cases may be illustrated by that where the officers of a corporation empowered to build and operate a certain line of railroad, purchased iron to be used for another line without the knowledge of the vendee. So, in case of Humphrey v. Patron's Mercantile Assn., 50 Iowa, 607, the debts of the corporation were, by its articles, limited to a certain amount; but the officers of the association, in dealing with Humphrey, exceeded that amount without his knowledge or means of knowledge, and the corporation was held. Thompson *v.* Lambert, 44 Iowa, 239, belongs to the same class of cases, with the addition that in the last case the stockholders who objected to what they termed an *ultra vires* contract were charged with knowledge of and participation in the act they claimed to be illegal and were in no condition to complain. A corporation cannot retain benefits derived from an *ultra vires* contract; and at the same time treat the contract as entirely void, unless, perhaps, in cases where the other party has assisted willfully in putting it beyond the power of the corporation to return what is received on such contract. (6) Where the corporation has permitted its officers to engage in *ultra vires* transactions, the officers commit a wrong or tortious act without the fault of the injured party, the corporation is estopped from taking advantage of the *ultra vires* character of the original undertaking." As to the doctrine that charters not expressly or by implication authorizing an act prohibit it and render such act void, see Safford *v.* Wyckoff, 1 Hill, 11; Leavitt *v.* Palmer, 3 Comst. 19; Talmage *v.* Pell, 3 Seld. 328; Tracy *v.* Talmage, 14 N. Y. 162, 179; Bissell *v.* Michigan So., etc., R. R. Co., 22 N. Y. 258, 289; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62, 68; Alexander *v.* Cauldwell, 83 N. Y. 480, 485; Nassau Bank *v.* Jones, 95 N. Y. 115, 122; New York Firemen Ins. Co. *v.* Ely, 5 Conn. 560, 572; Hood *v.* New York & New Haven R. R. Co., 22 Conn. 502; Elmore *v.* Naugatuck R. R. Co., 23 Conn. 457; Mutual Savings Bank *v.* Meriden Agency Co., 24 Conn. 159; Naugatuck R. R. Co. *v.* Waterbury Button Co., 24 Conn. 468. Contracts held *ultra vires* and void: Twiss *v.* Guaranty Life Assn. of Iowa, (1893) 87 Iowa, 733; s. c., 55 N. W. Rep. 8,

paying the taxes thereon, performing certain contracts theretofore made by the former company and the payment to the former company, or to its use, certain sums of money, was *ultra vires*, based upon the doctrine that a charter granted to a railway corporation for the purpose of constructing, owning and maintaining a railroad, confers a trust special to the corporation in relation to the purposes of its creation, and hence such a corporation has no power to enter into contracts foreign to those for which it was created, or to delegate its franchises, or to incapacitate itself to discharge its duties to the public by a lease or sale of its road. Agreements of that character, unauthorized by its charter, are inconsistent with the obligations of the corporation to the public, *ultra vires* and void.[1] The court held that the contract for lease

following Lucas *v.* Transfer Co., 70 Iowa, 542; s. c., 30 N. W. Rep. 771. See on *ultra vires* Wardner, Bushnell & Glessner Co. *v.* Jack, 82 Iowa, 435; Carson City Sav. Bank *v.* Elevator Co., 90 Mich. 550; Seymour *v.* Association, 64 Hun, 632; Richelieu Hotel Co. *v.* Encampment Co., 140 Ill. 248; s. c., 29 N. E. Rep. 1044, affirming 41 Ill. App. 268; Dewey *v.* Railway Co., 91 Mich. 351; Heims Brewing Co. *v.* Flannery, 137 Ill. 309; Buckeye Marble & Freestone Co. *v.* Harvey, (1892) 92 Tenn. 115; s. c., 20 S W. Rep. 427; As to a corporation with the usual powers, when not prohibited by its articles of incorporation, contracting for the surrender of its stock, see Rollins *v.* Shaver Wagon & Carriage Co., (1890) 80 Iowa, 380; s. c., 45 N. W. Rep. 1037. When a plea of *ultra vires* will be held sufficient. Gillespie *v.* Davidge Fertilizer Co., 66 Hun, 627; s. c., 20 N. Y. Supp. 833. When a contract will not be declared *ultra vires*. Nashua & Lowell Railroad Corp. *v.* Boston & Lowell R. Corp., (1892) 157 Mass. 268; s. c., 31 N. E. Rep. 1060; Odd Fellows Hall Association of Portland *v.* Hegele, (1893) 24 Ore. 16; s. c., 32 Pac. Rep. 679; Welsh *v.* Ferd Heim Brewing Co., 47 Mo. App. 608; Glass *v.* Ferd Heim Brewing Co., 47 Mo. App. 639; United Lines Telegraph Co. *v.* Boston Safe Deposit & Trust Co., 147 U. S. 431; s. c., 13 Sup. Ct. Rep. 396. For illustrations of contracts which have been held not to be *ultra vires*, see Wolf *v.* Arminus Copper Mine Co., 6 Misc. Rep. 562; s. c., 27 N. Y. Supp. 642, in which Abbot *v.* Rubber Co., 33 Barb. 578, was distinguished; Ashenbroedel Club *v.* Finlay, 53 Mo. App. 256. As to *ultra vires* generally, see Oelbermann *v.* New York & N. Ry. Co., 77 Hun, 332; s. c., 29 N. Y. Supp. 545; Pauly *v.* Coronado Beach Co., 56 Fed. Rep. 428; Denny Hotel Co. *v.* Schram, 6 Wash. 134. Estopped to plead *ultra vires*. Kennedy *v.* California Sav. Bank, (1894) 101 Cal. 495; s. c., 35 Pac. Rep. 1039; Kadish *v.* Garden City Equitable Loan & Bldg. Assn., 47 Ill. App. 602; Smith *v.* White (Tex. Civ. App.) 25 S. W. Rep. 809; Head *v.* Cleburne Bldg. & Loan Assn., (Tex. Civ. App.) 25 S. W. Rep. 810; Cameron *v.* First Nat. Bank, 4 Tex. Civ. App. 309; s. c., 23 S. W. Rep. 334; Butte Hardware Co. *v.* Schwab, (Mont.) 34 Pac. Rep. 24; Magee *v.* Pacific Improvement Co., 98 Cal. 678; s. c., 33 Pac. Rep. 772.

[1] Board of Commissioners of Tippecanoe Co. *v.* La Fayette, Muncie & Bloomington R. R. Co., (1875) 50 Ind. 85.

of this road was made without authority of law; that the board of directors and agents of the corporation had no power to make it; and that it was in violation of the rights of the stockholders and in contravention of public policy.[1] The court said, however: "We do not decide that railroad companies cannot become lessors or lessees of other railroad companies, or make other contracts with other railroad companies, for the purpose of running their lines in conjunction, facilitating commerce, travel and transportation, or for any of the legitimate purposes for which railroad companies are organized. There is much in the legislation of the state favoring this view, and many decisions of this court sustaining the advancing enterprise of the country, but all such contracts must come within the powers of the agency that makes them, and must not violate the rights of stockholders or contravene public policy.[2] It was contended in this case that the Indiana statute of February 23, 1853, entitled an "act to authorize railroad companies to consolidate, etc.," had removed this disability which these principles of law imposed upon such corporations. The Supreme Court held adversely to the contention.[3] It

[1] Ibid.; citing in support of these conclusions: 1 Redf. on Railways, 226, 594, 616, 641, 644, 650; Boston, etc., R. R. Corp. *v.* Salem, etc., R. R. Co., 2 Gray, 1; Black *v.* Delaware, etc., Canal Co., 7 C. E. Green (N. J.), 130; Bissell *v.* Michigan Southern, etc., R. R. Co., 22 N. Y. 258; Fall River Iron Works Co. *v.* Old Colony, etc., R. R. Co., 5 Allen, 221; Great Luxembourg Ry. Co. *v.* Magnay, 25 Beav. 586; Beman *v.* Rufford, 1 Sim. (N. S.) 550; Bagshaw *v.* Eastern Union Ry. Co., 2 Macn. & G. 389; Bank of Middlebury *v.* Edgerton, 30 Vt. 182; Marsh *v.* Fulton Co., 10 Wall. 676; Colman *v.* Eastern Counties Ry. Co., 10 Beav. 1; Township of Pine Grove *v.* Talcott, 19 Wall. 666; East Anglian Ry. Co. *v.* Eastern Counties Ry. Co., 11 C. B. 775; Richardson *v.* Sibley, 11 Allen, 65; Eidman *v.* Bowman, 58 Ill. 444; Stewart's Appeal, 56 Pa. St. 413; Madison, etc., Plank Road Co. *v.* Watertown, etc., Plank Road Co., 7 Wis. 59; Eldridge *v.* Smith, 34 Vt. 484; Perrine *v.* Chesapeake, etc., Co., 9 How. 172; Bedford R. R. Co. *v.* Bowser, 48 Pa. St. 29; Pearce *v.* Madison, etc., R. R. Co., 21 How. 441; European, etc., Ry. Co. *v.* Poor, 59 Me. 277; Wright *v.* Bundy, 11 Ind. 398; Eaton & Hamilton R. R. Co. *v.* Hunt, 20 Ind. 457; Board of Comrs., etc., *v.* Reynolds, 44 Ind. 509; Sparrow *v.* Evansville, etc., R. R. Co., 7 Ind. 369; Fisher *v.* Evansville, etc., R. R. Co., 7 Ind. 407; Booe *v.* Junction R. R. Co., 10 Ind. 93; McCray *v.* Junction R. R. Co., 9 Ind. 358; Shelbyville, etc., Turnpike Co. *v.* Barnes, 42 Ind. 498.

[2] Board of Commissioners of Tippecanoe Co. *v.* La Fayette, Muncie & Bloomington R. R. Co., (1875) 50 Ind. 85, 115.

[3] Ibid. The court said: "That act is 'to authorize railroad companies to consolidate their stock with the stock

appeared in a case before the United States Supreme Court that a corporation organized under the laws of Pennsylvania as a manufacturing corporation with a certain capital stock, for twenty years, for "the transportation of passengers in railroad cars constructed and owned by the said company" under certain patents, carried on the business of manufacturing sleeping cars under its patents, and of hiring or letting the cars to railroad companies by written contracts, receiving a revenue from the sale of berths and accommodations to passengers. Seven years afterwards, by special statute, the charter was extended for ninety-nine years, and the corporation was empowered to double its capital stock, and "to enter into contracts with corporations in this or any other state for the leasing or hiring and transfer to them, or any of them, of its railway cars and other personal property." Upon the passage of this statute this corporation entered into a contract with a corporation of another state organized for similar purposes, by which it leased and transferred to the latter all its cars, railroad contracts, patent rights and other personal property, moneys, credits and rights of action, for the term of ninety-nine years, except so far as the contracts and patents shall expire sooner; and covenanted not to "engage in the business of manufacturing, using or hiring sleeping cars" while the contract should remain in force; the lessee engaged to pay all the existing debts

of railroad companies in this or in an adjoining state, and to connect their roads with the roads of said companies,' etc. The title nowhere mentions a lease or a sale. Indeed, the words 'to connect their roads with the roads of said companies' would seem to exclude such a conclusion. To connect one road with another does not fairly mean to lease it or sell it to another. Much less can it mean to authorize the corporation to sever the trunk of its road, transfer the western division, for an unlimited time, to the corporation of another state, and subordinate its eastern division to the western and to a foreign corporation. The third section of the act is not strongly relied upon. It enacts that a railroad company 'shall have power to make such contracts and agreements with any such road constructed in an adjoining state, for the transportation of freight and passengers, or for the use of its said road, as to the board of directors may seem proper.' Even if this section could be held to authorize the transfer of the use of one road to another, the words cannot fairly mean the transfer of one division of a road to the injury of another division of the same road, thus putting the two divisions in direct antagonism, both in their interest and connection. Although the words, 'as to such board of directors may seem proper,' express a general power, they must be construed in reference to the subject-matter to which they are applied, and limited within the powers of the corporation and the rights of the stockholders."

of the lessor corporation and to pay a fixed sum annually, during the term of ninety-nine years, unless the contract was sooner terminated as provided in its terms. The lessor corporation brought this action to recover of the lessee corporation a large sum of money claimed to be due from it on this contract. The Supreme Court held the contract to be unlawful and void, because it was *ultra vires* the corporate powers of the lessor corporation and involved an abandonment of its duty to the public; also, that the suit was not maintainable nor could there be a recovery by the lessor corporation upon the contract even though the lessee had enjoyed the benefits of the contract.[1] In the United States

[1] Central Transportation Co. *v.* Pullman's Palace Car Co., (1891) 139 U. S. 24; s. c., 11 Sup Ct. Rep. 478. Mr. Justice GRAY in the opinion which he delivered for the court quoted from and reviewed the following cases: York & Maryland Railroad *v.* Winans, 17 How. 30; Pearce *v.* Madison & Indianapolis Railroad, 21 How. 441; Zabriskie *v.* Cleveland, etc., Railroad, 23 How. 381; Thomas *v.* Railroad Co., 101 U. S. 71; Branch *v.* Jesup, 106 U. S. 468; Pennsylvania Railroad *v.* St. Louis, etc., Railroad, 118 U. S. 290; Salt Lake City *v.* Hollister, 118 U. S. 256; Willamette, etc., Co. *v.* Bank of British Columbia, 119 U. S. 191; Green Bay & Minnesota Railroad *v.* Union Steamboat Co., 107 U. S. 98; Pittsburgh, etc., Railway *v.* Keokuk & Hamilton Bridge, 131 U. S. 371; Oregon Railway *v.* Oregonian Railway, 130 U. S. 1. Upon a contention that the lessor corporation was on a different footing from railroad corporations and the like, it was said: "The plaintiff * * * was not an ordinary manufacturing corporation, such as might, like a partnership or an individual engaged in manufactures, sell or lease all its property to another corporation. Ardesco Oil Co. *v.* North American Oil Company, 66 Pa. St. 375; Treadwell *v.* Salisbury Manuf. Co., 7 Gray, 393. But the purpose of its corporation, as defined in its charter, and recognized and confirmed by the legislature, being the transportation of passengers, the plaintiff exercised a public employment, and was charged with the duty of accommodating the public in the line of that employment, exactly corresponding to the duty which a railroad corporation or a steamboat company as a carrier of passengers owes to the public independently of possessing any rights of eminent domain. The public nature of that duty was not affected by the fact that it was to be performed by means of cars constructed and of patent rights owned by the corporation, and over roads owned by others. The plaintiff was not a strictly private, but a *quasi* public corporation; and it must be so treated as regards the validity of any attempt on its part to absolve itself from the performance of those duties to the public, the performance of which by the corporation itself was the remuneration that it was required by law to make to the public in return for the grant of its franchise. Pickard *v.* Pullman Southern Car Co., 117 U. S. 34; York & Maryland Railroad *v.* Winans, 17 How. 30, 39; Railroad Co. *v.* Lockwood, 17 Wall. 357; Liverpool & Great Western Steam Co. *v.* Phœnix Ins. Co., 129 U. S. 397." After referring to the express pow-

Circuit Court for the northern district of Washington it has been held that a railroad company organized under the laws of that state has no authority to transfer its franchises, except by sale and conveyance or lease made in accordance with the statutes relating to the transfer of titles to such property; and where by a so-called "traffic agreement," the trustees, without the consent of the minority stockholders, in effect, transferred to another railroad company the entire control and management of the property, for practically the legal lifetime of the corporation, such contract was illegal and void.[1] The Supreme Court of New

ers conferred upon the corporation, it was said: "Considering the long term of the indenture, the perishable nature of the property transferred, the large sums to be paid quarterly by the defendant by way of compensation, its assumption of the plaintiff's debts and the frank avowal, in the indenture itself, of the intention of the two corporations to prevent competition and to create a monopoly, there can be no doubt that the chief consideration for the sums to be paid by the defendant was the plaintiff's covenant not to engage in the business of manufacturing, using or hiring sleeping cars; and that the real purpose of the transaction was, under the guise of a lease of personal property, to transfer to the defendant nearly the whole corporate franchise of the plaintiff, and to continue the plaintiff's existence for the single purpose of receiving compensation for not performing its duties." This case has been followed in Hamilton *v.* Savannah, F. & W. Ry. Co., (1892) 49 Fed. Rep. 412.

[1] Earle *v.* Seattle, Lake Shore & Eastern Ry. Co., (1893) 56 Fed. Rep. 909. The only authority found in the charter of the company which had thus leased the control of the Washington corporation, was where the congress of the United States had authorized it "to accept to its own use any grant, donation, loan, power, franchise, aid or assistance which may be granted to, or conferred upon said company by the congress of the United States, by the legislature of any state, or by any corporation, person or persons; and said corporation is authorized to hold and enjoy such grant, donation, loan, power, franchise, aid or assistance to its own use for the purpose aforesaid." In the opinion rendered in this case it is said: "The statute referred to does not prescribe the manner whereby purchases or leases of railways may be consummated, otherwise than by the general provisions of the several statutes relating to corporations and to conveyances of property. A railroad corporation cannot lawfully transfer its franchise without authority emanating from the power which granted it. And an unauthorized transfer, made in disguise, as by a traffic contract, will not, in a judicial proceeding, be treated with greater favor than if the contract expressed plainly the real intention of the parties. On the subject of traffic contracts the text of Green's Brice's Ultra Vires (page 427), concisely and clearly states the law, as follows: 'Corporations may make all necessary arrangements for cheaply and expeditiously developing or carrying on their particular business; but it is another thing, going beyond this, to enter into contracts, for instance, by which the exclusive control or the exclusive right of working the line is handed over to other parties. All such arrangements, whatever their form, however disguised, are *ultra vires* and void. This applies with peculiar force in the case of those bodies which have been created for what may be conveniently styled 'public purposes.'" The court continued: "Now, assuming that the section of the charter above quoted does authorize the Northern Pacific Railroad Company to take the benefit of rights and privileges, and exercise new powers, granted and conferred by the state of Washington, the question whether the contracts and proceedings by which it has gained control of the Seattle, Lake Shore and Eastern Company's franchise and business are *ultra vires* or not depends upon whether the requirements of the state laws in this regard have been met. There has been no sale and conveyance, nor lease, of the railroad property, in accordance with the laws of this state relating to the manner of transferring titles to such property. As the parties have not done what the statute authorizes to be done, I do not think that the deal between them has any governmental sanction whatever. No consolidation has been attempted, and yet the transaction is of such resemblance to a consolidation that the legal principles by which the validity of proceedings to effect a consolidation of corporations may be applied. This idea leads to consideration of the contract rights of individual stockholders, and the rule is that a corporation cannot be consolidated with another if the right to do so was not by the law, or the constituting instruments, given at the time of its creation, without the unanimous consent of its stockholders. The law on this subject is thus stated in 2 Mor. Priv. Corp. § 951: 'A corporation cannot consolidate with another company, even pursuant to legislative authority, except with the consent of all its shareholders. An unauthorized consolidation may be prevented by any dissenting shareholder, or may be treated as ground for severing his connection with the company, by a rescission of his subscription.'"

[1] Small *v.* Minneapolis Electro-Matrix Co., (1890) 10 N. Y. Supp. 456.

York, in General Term, affirmed the denial of a motion to continue an injunction restraining the directors of a corporation from transferring its property, assets and business to another corporation, where it appeared from affidavits of the directors that they did not contemplate such action, but merely the leasing of important rights and functions to the other corporation.[1] This was a case where a stockholder of a Minnesota corporation had made complaint, in which he alleged that eight of the nine directors of the company owned or controlled a majority of the shares of stock, and were disposed to lease and transfer the property and effects of the company for the term of twenty-five years to a corporation created under the laws of the state of New Jersey, and, in effect, to transfer its business to that company, for one-half the net profits yielded by it; and that this was in contravention of its charter, and the laws of the state of

Minnesota, under which it was incorporated. DANIELS, J., for the court, said: "If the facts were satisfactorily established, a case for an injunction would be presented; for the directors or trustees do not appear to have been invested with that power, either by its charter or the laws of the state in which it exists; and, in the absence of explicit authority to transfer its property, effects and business to another company, it cannot be presumed to possess that power. At least, the directors or trustees, having only the power to manage and conduct its affairs under the charter, could legally make no such disposition of its property and affairs; for, instead of managing and conducting its business, that would be a destruction of its business, and an abdication of their own powers and authority, which could not take place without violating the law and their own official obligations; and that, even a majority owner of the shares of the company would be entitled by action to restrain and prevent."[1] Referring to the admission in the answer of the directors, that a resolution was adopted by the majority of the board, subject to the approval of the shareholders, to execute a lease to the New Jersey corporation of certain important rights and functions of the Minnesota corporation, and the stated intention to extend the leasehold interests or rights no further than was permitted by the laws of Minnesota, it was said: "And it certainly goes no further in its language or fair implication to this extent, which does not transcend, but limits itself within the bounds of the law; for the exercise of lawful authority for the promotion of the interests and prosperity of the company is intrusted to the use and employment of its board of directors or trustees; and when they may, in good faith, be exercised, a case will not be presented for the interposition of a court of equity by injunction."[2]

§ 274. Loaning funds of corporation.— The power in a corporation to loan its funds cannot be implied from the power expressly given it to borrow money, or any implied power it has to borrow; and if it has no express power given it to loan its funds, it cannot be implied from the declared purposes and objects for which its charter was granted where it is not created for banking purposes, or to conduct some business usual in bank-

[1] Citing Abbot *v.* Rubber Co., 33 Barb. 578, 591.

[2] Citing Beveridge *v.* Railroad Co., 112 N. Y. 1; s. c., 19 N. E. Rep. 489.

ing; and in case the corporation is not created, as may appear from its articles of incorporation, for pecuniary profit, this declaration would exclude the power of loaning its funds.[1] And where a corporation has no power to loan its funds, a promissory note and mortgage given as security to the corporation will be void and not enforceable in equity.[2] An Alabama corporation was incorporated with a capital of $1,000,000, to be paid in in cash and such other money as it might receive in trust, one-half of which capital it was required to invest in bonds or notes secured by mortgage on land within the state of Alabama, and the remaining half of the capital stock, together with the premiums and profits received by it, and the moneys received in trust, may be invested in stocks, loaned to any city, county or company, or be invested in such real or personal securities as it might deem proper. The Supreme Court of Alabama held that the corporation had no power to lend its credit by making bonds to fall due in future, and exchanging such bonds for the bonds of an individual for the same amount.[3] A corporation organized under the laws of California for the purpose of acquiring a certain tract of land, laying it out as a town and selling it in lots, blocks, etc., and acquiring "street railroad or other rights and franchises, telegraph, telephone or other similar franchises, and gas and electric light franchises, over the said property, or any part thereof," subscribed for shares of stock in a manufacturing corporation. Such subscription was held to be *ultra vires* and void.[4]

[1] Chambers *v.* Falkner, (1880) 65 Ala. 448.

[2] Ibid.

[3] Smith *v.* Alabama Life Insurance & Trust Co., (1843) 4 Ala. 558. This same corporation was held, under its articles of incorporation, to have the power to purchase a bill of exchange, in Gee *v.* Alabama Life Ins. & Trust Co., (1848) 13 Ala. 579.

[4] Pauly *v.* Coronado Beach Co., (1893) 56 Fed. Rep. 428. The court placed its ruling upon the doctrine on this subject as summed up by the Supreme Court of the United States, in Central Transportation Co. *v.* Pullman's Palace Car Co., 139 U. S. 48; s. c., 11 Sup. Ct. Rep. 484, in these words: "The charter of a corporation read in the light of any general laws which are applicable, is the measure of its powers, and the enumeration of those powers implies the exclusion of all others not fairly incidental. All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts; and this, upon three distinct grounds: The obligation of every one contracting with a corporation to take notice of the legal limits of its powers; the interest of the stockholders not to be subjected to risks which they have

§ 275. Investing funds of corporation in stock of others.— In a Maine case it appeared that a savings institution subscribed for $50,000 of the capital stock of a manufacturing corporation. Having no money to pay for it, another corporation paid the money to the manufacturing corporation, took the notes of the savings institution for the amount, and had a certificate of stock issued in its name as collateral security for the payment of the notes. The Supreme Court of Judicature of that state held that upon principle, as well as authority, it was not within the authority of the trustees of a savings institution to invest its funds in the stock of a manufacturing corporation, unless expressly authorized so to do by its charter, or the public laws of the state. They placed their decision against the power of the savings bank to enter into this contract upon the broader ground that it was not competent for the trustees of the savings bank to purchase on credit property of any kind, not needed for immediate use or the investment of existing funds; that such power was not expressly conferred upon it, nor could it be sustained as an incidental power.[1]

never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law." In Richelieu Hotel Company *v.* International Military Encampment Co., (1892) 140 Ill. 248; s. c., 29 N. E. Rep. 1044, a subscription by this incorporated hotel company to V., a contemplated corporation for the purpose of establishing this encampment to draw visitors to the city, etc., was held foreign to the purposes of the hotel company, and the doctrine of *ultra vires* must be applied to it.

[1] Franklin Company *v.* Lewiston Institution for Savings, (1877) 68 Me. 43. The ruling as to the first point was based upon what the court considered the result of the rules declared in the following cases bearing upon the powers of corporations, to wit: Beaty *v.* Lessee of Knowler, 4 Pet. 152; s. c., 1 McLean, 41; Perrine *v.* Chesapeake & Delaware Canal Co., 9 How. 172; Farnum *v.* Blackstone Canal Co., 1 Sumner, 46; Bank of Augusta *v.* Earle, 13 Pet. 519; Tombigbee R. R. Co. *v.* Kneeland, 4 How. 16; Runyan *v.* Coster's Lessee, 14 Pet. 122; Dartmouth College *v.* Woodward, 4 Wheat. 518, 636; Hood *v.* New York & N. H. Railroad, 22 Conn. 1 and 502; Berry, Receiver, *v.* Yates, 24 Barb. 199; Mutual Savings Bank *v.* Meriden Agency Co., 24 Conn. 159; Sumner *v.* Marcy, 3 Woodb. & Min. 105; Pearce *v.* Railroad, 21 How. 441. It was suggested in Franklin Company *v.* Lewiston Institution for Savings, *supra*, that it might be convenient in this way to provide in advance for the investment of funds that might afterwards come into the possession of a bank. To this the court said: "We think the creation of debts by corporations or individuals for no other purpose than to provide a ready way to dispose of future acquisitions a proceeding of very questionable convenience; that in the great majority of cases it would be likely to prove, as it did in this case, very inconvenient. But it is sufficient answer to say that the law imposes no duty upon the trustees of savings banks to provide for the investment of future funds or future deposits. The whole duty is performed when they have provided safe investments for the funds already committed to their care. To hold that they may create debts binding upon existing depositors whose money, after all, may never be committed to their care, would be a doctrine as startling as it would be unprecedented."

It was further held in this case that the lender of the money, the corporation plaintiff, having participated in the illegal transaction, could not claim the privileges of a *bona fide* holder of commercial paper; and that the savings institution, having received no benefit from the transaction, was not estopped to set up the defense of *ultra vires*.[1] In an action brought by one Ohio corporation, an iron company, against another, a railway company, for goods sold and delivered to the latter, the defense made was that there had been a contract between the two corporations, by the terms of which the iron company was to sell to the railway company goods to a certain amount, and to receive in payment thereof so many shares of stock in the latter. This involved the question of the authority of the iron company to take stock in the railway company. Upon this subject the Supreme Court of Ohio stated the law in that state to be as follows: "We think it well settled as a result of the decisions in this state, as well as elsewhere, that an incorporated company cannot, unless authorized by statute, make a valid subscription to the capital stock of another; that such subscription is *ultra vires*, and void. Mr. Morawetz, in stating this to be the law, observes: 'The right of forming a corporation is conferred by the incorporation laws only upon persons acting individually, and not upon associations; moreover, it would, under ordinary circumstances, be a violation of the charter of an existing company to subscribe for shares in a new company and assume the resulting liabilities.' Priv. Corp. § 433. There has been no direct decision upon the question by this court, but such has been the universal holding elsewhere.[2] These cases all proceed upon the principle that the powers of corporations organized under legislative statutes are such and such only, as those statutes confer, or that may be fairly implied therefrom. This doctrine was clearly announced and applied in Straus *v.* Eagle Ins. Co., 5 Ohio St. 59, and has been firmly adhered

[1] Franklin Co. *v.* Lewiston Institution for Savings, (1887) 68 Me. 43.

[2] Citing Railroad Co. *v.* Railroad Co., 31 N. J. Eq. 475; Franklin Co. *v.* Lewiston Savings Inst., 68 Me. 43; Railroad Co. *v.* Collins, 40 Ga. 582.

to in this court. Railroad Co. v. Hinsdale, 45 Ohio St. 556, 573. No claim is made by the defendant that the iron company had any express statutory authority to use its capital or assets in aid of the construction of a railroad by subscription to its capital stock or otherwise. The only averment as to this, is that it, the iron company, conceived that it would be benefited by the reduction of the price of coal at Cleveland, its place of business, and the market which the construction of the road would afford for its manufactures, and by these considerations was induced to make the subscription. But all this can be of no avail in the face, at least, of the prohibition contained in section 3266 of the Revised Statutes, that, 'No corporation shall employ its stock, means, assets or other property, directly or indirectly, for any other purpose whatever, than to accomplish the legitimate objects of its creation.' There was then, as we think, no authority whatever in the iron company to make a valid subscription to the capital stock of the railway company * * * ."[1]

§ 276. Directors of an insurance company raising a guaranty capital.— The directors of a mutual life and fire insurance company, a New Jersey corporation, after conducting its business for a while, by resolution determined upon and formulated a plan to raise a guaranty capital to the amount of $150,000, to be used for the payment of losses when other means were exhausted. This was done by obligations for money secured by mortgage from its members. Here we have an action on a bill filed to recover on the defendant's mortgage what had been assessed against him. The answer of defendants set up the facts and circumstances under which the mortgage was given, and insisted that the action and all the proceedings of the directors in raising the guaranty capital were illegal, in violation of the charter of the company and against public policy, and, therefore, the company could not enforce the contract made with any of the contributors to the fund. After expressing that his disposition was to enforce this contract on the part of the contributors, upon the question directly raised, Chancellor Williamson said: "I cannot see how the contract with the contributors to this guaranty fund can be enforced in a court of law or equity, without repudiating altogether the principle of the common law,

[1] Railway Co. *v.* Iron Co., (1888) 46 Ohio St. 44, 49, 50.

which has been but re-enunciated by our statute (Nixon, 138, § 3), that no corporation shall possess or exercise any corporate powers, except such as shall be expressly given in its charter, or which shall be necessary to the exercise of the powers so enumerated and given. Was it within the scope of the powers of this corporation to provide any other capital or fund as the basis of the basis which it was empowered to pursue, than are provided by the charter itself? If it was illegal for them to create such a capital, then a contract which they may have made for its payment cannot be enforced. This corporation was incorporated for the purpose of insuring lives and loss by fire. The charter provides the fund out of which losses are to be paid, and it is this feature in the charter which stamps the character of this corporation, and which makes it what its name imports, and what the legislature intended it should be, a *mutual* company. The corporators are mutual insurers, and it is the fund which is made up from the premiums which they contribute, and one per cent on the amount for which each one is insured, out of which they are to be indemnified for any losses. They have no right or authority, by their charter, to create any other fund for the purpose. If they do, it is in violation of the principle which is to govern their mode of doing the business for which they were incorporated."[1]

[1] Trenton Mutual Life & Fire Insurance Co. *v.* McKelway, (1858) 12 N. J. Eq. 133, 135, 136. *Arguendo*, the chancellor further said: "It was admitted, on the argument, that it was not within the scope of the powers of this corporation to create any capital other than that for which the charter provides. It was attempted to escape the consequences of such an act by the argument that this was nothing more than a contract for a loan of money, out of which the corporation might be enabled to meet the losses that might be incurred. It cannot be denied but that the corporation might borrow money under some circumstances, and that a contract *bona fide* made for such loan would be illegal [legal ?], and not in contravention of the charter. For instance, should the corporation incur a loss, and not have the available means promptly to meet it, it would not be illegal for them to make a loan to meet the exigency. But they cannot, under pretense of borrowing money, provide a fund for the purpose of giving credit to the company. The question is as to the *bona fides* of the transaction. It matters not what you call it, the name does not affect its real character. Was this a *bona fide* loan of money, or a contract for a loan, made in the ordinary course of business, and to meet an exigency which would bring such a contract within the compass of the legitimate powers of the company? Or was it a contract to provide a capital or fund for the purpose of giving a credit and character to the company which is entirely for-

§ 277. Converting "common" into "preferred" stock.— In a leading New York case, while the Court of Appeals admitted the right of corporations to classify their stock at the outset by issuing some "common" and some "preferred" stock, it was held that it was not, under the circumstances disclosed, in the power of the corporation involved in this case to convert some of its shares into preferred with a view of raising money from its stockholders, as it was not a "borrowing" of money in its proper sense, but an interference with the vested rights of the stockholders as originally constituted.[1] A manufacturing corporation

eign to its charter? Can this be called a legitimate contract for a loan in the ordinary course of business?" The chancellor then stated the terms of the contract, and, as to the acts of the directors in the matter, said: "They did not make the contract under a mistake, intending to make a mere loan, and supposing that they were legitimately exercising a power to do so. That was not their purpose. They had a different object in view. It is expressed in their bill of complaint, and recorded several times upon their minutes. The bill of complaint alleges that the directors concluded to enter into this negotiation because, in their opinion, it would prove advantageous to the corporators to provide a guaranty capital as an additional security for the payment of losses. Here, then, is the admission of the company upon the record, that this contract was made for an illegal purpose. The minutes of the corporation show more; they show that this was a device for the purpose of complying with the laws of the state of New York, which provides that no insurance company shall transact business in that state unless such company is possessed of an actual capital of $150,000. The simple question then is presented, could this corporation lawfully adopt any scheme or device by which they could create a capital of $150,000, for the purpose of acquiring a credit upon which to transact business? In my judgment, they could not, and any contract entered into for such a purpose is unlawful, and cannot be enforced."

[1] Kent *v.* Quicksilver Mining Co., (1879) 78 N. Y. 159. The court, however, would not declare that a corporation could never, rightfully, against the dissent of a portion of its stockholders, make some of its stock "preferred." FOLGER, J., speaking for the court, said: "The transaction is not to be looked upon as other than a preference of one class of stockholders to another; as giving to the first class a perpetual, inextinguishable prior right to a portion of the earnings of the company before the other class might have anything therefrom. It was none other than the creation of a 'preferred stock.' Then there arises the query whether there was at that time power in the corporation to distinguish between the stockholders in it, to form them into two classes, and to give to one class rights in the corporate property, business and earnings from which the other was shut out. We are not prepared to say that, at the first, the corporation might not have lawfully divided the interest in its capital stock into shares arranged in classes, preferring one class to another in the right it should have in the profits of the business. The charter gave power to make such by-laws as

organized under the laws of New York was organized with a capital stock of 7,500 shares. At a certain time it owed $300,000, and for the purpose of paying it, stockholders representing all the stock, except that mentioned hereafter, and the corporation executed under their hands and seals a contract by which the shareholders agreed to surrender to the corporation without consideration forty per cent of their stock, which

it might deem proper consistent with the Constitution and law; and to issue certificates of stock representing the value of the property. We know of nothing in the Constitution or the law that inhibits a corporation from beginning its corporate action by classifying the shares in its capital stock with peculiar privileges to one share over another, and then offering its stock to the public for subscriptions thereto. No rights are got until a subscription is made. Each subscriber would know for what class of stock he put down his name, and what rights he got when he thus became a stockholder. There need be no deception or mistake; there would be no trenching upon rights previously acquired; no contract, express or implied, would be broken or impaired. This corporation did otherwise. A by-law was duly made which declared the whole value of its property and the whole amount of its capital stock and divided the whole of it into shares equal in amount and directed the issuing of certificates of stock therefor. It is not to be said that this by-law authorized anything but shares equal in value and in right; or that the taker of one did not own as large an interest in the corporation, its capital, affairs and profits to come, as any other holder of a share. Certificates of stock were issued under this by-law that gave no expression of anything different from that. When that by-law was adopted it was as much the law of the corporation as if its provisions had been a part of the charter. Presbyterian Church *v.* City of New York, 5 Cow. 538. So it is said in Grant on Corporations, page 80, in a qualified way. Thereby, and by the certificate, as between it and every stockholder, the capital stock of the company was fixed in amount in the number of shares into which it was divisible, and in the peculiar and relative value of each share. The by-law entered into the compact between the corporation and every taker of a share; it was in the nature of a contract between them. The holding and owning of a share gave a right which could not be divested without the assent of the holder and owner; or unless the power so to do had been reserved in some way. Mech. Bank *v.* N. Y. & N. H. R. R. Co., 13 N. Y. 599–627. Shares of stock are in the nature of *choses in action*, and give the holder a fixed right in the division of the profits or earnings of a company so long as it exists, and of its effects when it is dissolved. That right is as inviolable as is any right in property, and can no more be taken away or lessened against the will of the owner than can any other right unless power is reserved in the first instance when it enters into the constitution of the right; or is properly derived afterwards from a superior law given. The certificate of stock is the muniment of the shareholder's title and evidence of his right. It expresses the contract between the corporation and his co-stockholders and himself; and that contract cannot, he being unwilling, be taken away from him or changed as to him without his prior dereliction or under the

amounted to the sum of the indebtedness, and authorized the corporation to pay upon shares to be issued and sold in the place of those surrendered ten per cent per annum on the face value of the shares for five years or such portion thereof as could be paid out of the annual net profits of the corporation. The following statement was indorsed upon the certificates for the 3,000 shares to be issued in lieu of those surrendered, to wit: "Issued subject to agreement with stockholders, dated May 22, 1885, on file in the treasurer's office, entitled to first lien on net profits to the amount in such agreement provided. [Signed.] Edw. L. Wood, *Treasurer*." The shares so issued were sold at par and the debt paid. On the back of the shares surrendered was printed, "Profits assigned." The certificates representing the shares which were not represented in the signature to the agreement above mentioned were at that time, with properly executed power of attorney for assignment and transfer, in the hands of a creditor of the owner of the shares as collateral security for a loan; the loan not being paid at maturity the shares were sold regularly to a purchaser, who brought this action against the company to have issued to him a certificate of shares to the amount named in the certificate so purchased, he having refused what was tendered him by the company, a certificate of shares with the words indorsed thereon of "Profits assigned." The New York Court of Appeals held that the purchaser was entitled to an unconditional certificate for these 100 shares upon the same principle as in the last case cited, that the action of the corporation here was an interference with the vested rights of the non-assenting stockholders.[1]

conditions above stated. Now it is manifest that any action of a corporation which takes hold of the shares of its capital stock already sold and in the hands of lawful owners and divides them into two classes, one of which is thereby given prior right to a receipt of a fixed sum from the earnings before the other may have any receipt therefrom and is given an equal share afterwards with the other in what earnings may remain — destroys the equality of the shares, takes away a right which originally existed in it and materially varies the effect of the certificate of stock. It is said that when a corporation can lawfully buy property or get money on loan, any known assurance may be exacted and given which does not fall within the prohibition, express or implied, of some statute (Curtis *v.* Leavitt, 15 N. Y. 9, 66, 67); and that is sought to be applied here. But the prohibition to such action as this is found, not indeed in a statute commonly so called, but in the constitutional provision which forbids the impairment of vested rights save for public purposes and on due compensation. The right which a stockholder gets on the purchase of his share and the issue to him of the certificate therefor is such a vested right. It is contended that the power so to do is an incidental and implied power necessary to the use of the other powers of the corporation, and is a legitimate means of investing money and securing the agreed consideration therefor. We have already conceded that it is legitimate to borrow money and to secure the repayment of it with a compensation for the use of it. But that is when it is done in such way as to put the burthen upon every share of stock alike, and to enable every share of stock to be relieved therefrom alike, in such way as to preserve the equality of right and privilege and value of the shares, and maintain intact the contract thereto with the stockholder." The court then called attention to the distinguishing points in the cases relied upon to support the views *contra* to those of the court as follows: "Citations are made to us for the converse of this; but they do not come up — sometimes in their facts, sometimes in their declarations — to the necessity of the proposition. Either it is where the capital is not limited and it is new shares that may be issued with a preference, and where there is express power to borrow on bond and mortgage (2 Redf. on Rways. chap. 33, sect. 4; Harrison *v.* Mex. Rw., 12 Eng. Rep. 793); or the amount of the capital has not been reached and such stock is issued therefrom (Hazelhurst *v.* Savannah R. R., 43 Ga. 53; Totten *v.* Tison, 54 Ga. 139); or there was legislative authority (Davis *v.* Proprietors, 8 Met. 321; Rutland R. R. Co. *v.* Thrall, 35 Vt. 545); or a restriction to authorized capital and there was unanimous consent of the stockholders (Prouty *v.* M. S. & N. I. R. R., 1 Hun, 663; 43 Ga. 53, *supra*); or there was power to redeem, which was a transaction in the nature of a debt (Westchester, etc., R. R. Co. *v.* Jackson, 77 Pa. St. 321); or the opinion was *obiter* (Bates *v.* Androscoggin R. R. Co., 49 Me. 491); or it was the case of a subscription for stock with a condition for interest until the corporation was in operation (Richardson *v.* Vt. & Mass. R. R. Co., 44 Vt. 613); or it was an action on a subscription more favorable to defendant than to other subscribers, and it was held that defendant could not set up the lack of equality (Evansville R. R. Co. *v.* Evansville, 15 Ind. 395); or a solemn determination of this question was not necessary for the disposal of the case (Williston *v.* M. S. & N. I. R. R. Co., 13 Allen, 400); or the issue was authorized by the articles of association (In re A'D. St. Nav. & Col. Co., 20 L. R. [Eq.] 339) or there was full knowledge on the part of all concerned (Lockhart *v.* Van Alstyne, 31 Mich. 81); or the power in the corporate body was conceded, and it was denied that it existed in the directors. McLaughlin *v.* D. & W. R R., 8 Mich. 100."

§ 278. The effect of laches on the part of complaining stockholders in such cases. — In the leading New York case, where the conversion of common stock into preferred was held to have been *ultra vires* the corporation, the findings of the court on the trial showed that the by-laws empowering the creation

[1] Campbell *v.* American Zylonite Co., (1890) 122 N. Y. 455. FOLLETT, Ch. J., very fully discusses the rights of stockholders in the opinion rendered in this case by him for the court.

and issue of the preferred stock were authorized at a stockholders' meeting regularly called and held and conducted; that the stock was at once offered for subscription to all of the stockholders; that a circular informing them thereof was issued by authority and distributed to the stockholders; that though all of them did not avail themselves of the chance to take it, it was not because the chance was not known. A large number of them did subscribe, and paid money for the privilege to the corporation, and that money went into the assets and business of the company; certificates for the preferred stock were thereupon issued, and it, as well as the common stock, was dealt in by the public; sales were made of the two kinds openly at the Stock Exchange at prices for the one larger than for the other, and quoted in the daily public prints; and from year to year for four years the annual reports of the directors to the stockholders spoke of the two kinds of stock. There was ample knowledge, or means of knowledge, on the part of all stockholders of the action of the corporation in the creation of the two kinds of stock; of the issue of certificates for the preferred stock; of the entry of that stock into the channels of trade; of the public dealings in it at the especial marts for the sale of such property, and of the continued recognition of its existence and validity by the company and the public. FOLGER, J., for the Court of Appeals, said: "It is not to be conceived that the owners of the common stock of this corporation did not have actual knowledge that there had been created a stock having ostensibly greater right and value than their own, and that it had gone into the market and was dealt in by the public interested in the validity of it. For the lapse of four years, however, there was no action of the company, or of an individual stockholder, to have a judicial declaration that the company had exceeded its powers in the creation of the stock, and that it was invalid. We think that these facts, most of which are set forth in the findings in two of the cases, warrant the conclusion of law therein, that the stockholders, by acquiescing in the action of the corporation in making the preferred stock, have ratified and assented thereto, and that the same is binding on them by reason of such assent and ratification."[1]

[1] Kent *v.* Quicksilver Mining Co., (1879) 78 N. Y. 159, 184, 185. As to the effect of laches in seeking to invalidate a lease of the franchises, etc., of a railroad corporation to another, see St. Louis, Vandalia & Terre Haute R. R. Co. *v.* Terre Haute & Indianapolis R. R. Co., (1892) 145 U. S. 393; s. c., 12 Sup. Ct. Rep. 953.

§ 279. Rules declared by courts as to estoppel of corporations to plead ultra vires.— If a contract by a corporation be not in violation of some public law, or contrary to public policy, *it seems* that only the immediate parties to it, as the corporation itself, or the stockholders, who are parties by representation, hold such a legal position in relation to the contract as to entitle them to raise the question of its validity on account of the alleged want of capacity to make; but if the contract be in violation of some public law or against public policy, in such sense as to make it void and of no effect to any intent, any person standing in a relation of interest to the subject-matter of the contract, and to be affected by its operation, might undoubtedly set up and insist on such fatal vice in it, for the purpose of clearing himself from the consequences of its being carried into effect.[1] In a fully considered case upon how far a corporation is estopped to set up the invalidity of an *ultra vires* contract, where fully performed on the part of the plaintiff, and the benefits of it received by the defendant as a defense to an action, the view of the United States Supreme Court thereon has been stated to be as follows: "A contract of a corporation which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and, therefore, beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it. When a corporation is acting within the general scope of the powers conferred upon it by the legislature the corporation, as well as persons contracting with it, may be estopped to deny that it has complied with the legal formalities which are prerequisites to its existence or to its action, because such requisites might in

[1] Vermont & Canada R. R. Co. *v.* Vermont Central R. R. Co., 34 Vt. 2. As to estoppel to plead *ultra vires*, see Chicago Building Society *v.* Crowell, 65 Ill. 453; City of East St. Louis *v.* East St. Louis Gas Light & Coke Co., 98 Ill. 415; Peoria & S. R. R. Co. *v.* Thompson, 103 Ill. 187; Millard *v.* St. Francis Xavier Academy, 8 Bradw. 341; Thomas *v.* Citizens' Horse Ry. Co., 104 Ill. 462.

fact have been complied with. But when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, or by acting upon it, to show that it was prohibited by those laws. * * * A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms; but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract. The fraud and the limits of the rule concerning the remedy, in the case of a contract *ultra vires*, which has been partly performed, and under which property has passed, can hardly be summed up better than they were by Mr. Justice MILLER, in a passage already quoted, where he said that the rule 'stands upon the broad ground that the contract itself is void, and that nothing which has been done under it, nor the action of the court, can infuse any vitality into it,' and that 'where the parties have so far acted under such a contract that they cannot be restored to their original condition the court inquires if relief can be given independently of the contract, or whether it will refuse to interfere as the matter stands.'"[1] The doctrine seems to be settled by the weight of modern authority that a private corporation cannot avail itself of the defense of *ultra*

[1] Central Transportation Co. *v.* Pullman's Palace Car Co., (1891) 139 U. S. 24, 59, 60, 61; s. c., 11 Sup. Ct. Rep. 478. These remarks of Justice MILLER are in Pennsylvania Railroad *v.* St. Louis, etc., Railroad, 118 U. S. 317. As to a bank being estopped to interpose the defense of *ultra vires* to defeat the execution of a trust in favor of its depositors in and lenders to its investment department, by which they were to be secured by reason of its having had the full benefit of the contract, see Ward *v.* Johnson, (1880) 95 Ill. 215; citing West *v.* Menard County Agricultural Board, 82 Ill. 206; Maher *v.* Chicago, 38 Ill. 266; Railway Co. *v.* McCarthy, 96 U. S. 267; San Antonio *v.* Mehaffy, 96 U. S. 315; Morris R. R. Co. *v.* Railroad Co., 20 N. J. Eq. 542.

vires where the contract has been, in good faith, fully performed by the other party, and the corporation has had the benefit of the contract and the performance.[1] Though a contract of a corporation may be strictly *ultra vires*, yet, if not interfered with by the stockholders or the state, and it be not of a class of contracts expressly prohibited, and there be reasonable ground to suppose that the agents of the corporation have acted in good faith, objections raised by the corporation itself or by one having no interest in the question, except for purposes of unjust advantage, will not be listened to by the courts.[2] If a contract made by officers of a corporation with third parties apparently within their powers, upon proof of extrinsic facts of which the third party had no notice, was beyond them, the corporation will be held liable unless it take timely steps to prevent loss or damage to the third parties.[3] A corporation will be estopped to take advantage of the *ultra vires* character of an original undertaking where its officers have been permitted by it to engage in such transactions, and in prosecution of them the officers commit a wrong or tortious act without the fault of the injured party.[4] The benefits derived from an *ultra vires* contract cannot be retained by the corporation and the contract treated as entirely void, unless, perhaps, in cases where the other party to the contract has assisted willfully in putting it beyond the power of the corporation to

[1] Darst *v.* Gale, (1876) 83 Ill. 136; citing Ex parte Chippendale, 4 DeGex, M. & G. 19; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; Bradley *v.* Ballard, 55 Ill. 413.

[2] Noyes *v.* Rutland & Burlington R. R. Co., 27 Vt. 110; Rutland & Burlington R. R. Co. *v.* Proctor, 29 Vt. 93; Sturges *v.* Knapp, 31 Vt. 62. As to who may or may not set up the defense of *ultra vires*, see Western Organ Co. *v.* Reddish, 51 Iowa, 55. As to estoppel of a stockholder to complain of an act *ultra vires* on the part of the corporation or its officers, see Des Moines Gas Co. *v.* West, 50 Iowa, 16, involving a fraudulent issue of bonds. Under what circumstances a stockholder cannot object to a plan of reorganization of a corporation as *ultra vires*, see Hollins *v.* St. Paul, M. & M. R. Co., (1889) 9 N. Y. Supp. 909. When an allegation in an answer that the contracts are *ultra vires* the corporation is a sufficient defense, see Gillespie *v.* Davidge Fertilizer Co., (1892) 66 Hun, 627; s. c., 20 N. Y. Supp. 833. When estoppel to defend on the ground that act was *ultra vires*, see Homestead Bank *v.* Wood, (Ct. Cm. Pl. N. Y. City, 1892) 20 N. Y. Supp. 640; s. c., 1 Misc. Rep. 145. Estoppel of corporations to plead *ultra vires*. Carson City Savings Bank *v.* Carson City Elevator Co., (1892) 90 Mich. 550; s. c., 51 N. W. Rep. 641; citing Day *v.* Buggy Co., 57 Mich. 151; Steel Works *v.* Bresnahan, 60 Mich. 337.

[3] Lucas *v.* White Line Transfer Co., 70 Iowa, 541; s.c., 30 N. W. Rep. 771.

[4] Ibid.

return what it received on the contract.[1] The Court of Civil Appeals of Texas has held that where the directors of a corporation, authorized by charter to establish and maintain a hotel, purchased competing hotel property and received the benefit of the transaction for two years they would not be heard to allege that the transaction was *ultra vires*.[2] A corporation cannot set up the limit of indebtedness fixed in its charter as a defense, where the consideration of the indebtedness has been received by it.[3] In like manner it would be estopped from setting up want of authority as a defense as against money advanced to pay indebtedness in excess of the limit of indebtedness fixed in its charter.[4] It is not beyond the powers of a corporation organized for the purpose of owning ditches for the conveyance and sale of water

[1] Ibid.

[2] Steger *v.* Davis, (Tex. Ct. App. 1894) 27 S. W. Rep. 1068. The court concluded its opinion in these words: "In the case of Publishing Co. *v.* Hitson, 80 Tex. 218; s. c., 14 S. W. Rep. 843, and 16 S. W. Rep. 551, the court says: 'It is a reasonable and 'voluntary rule' in its application to agencies, that where the principal, with knowledge of the facts, acquiesces in the acts done under an assumed agency he should not be heard subsequently to impeach them upon the ground that they were done without authority. Kelsey *v.* Bank, 69 Pa. St. 430. This rule applies to corporations as well as to individuals. An express assent, it is said, is not essential on the part of the stockholders to operate as an equitable estoppel upon them. It may be inferred from the failure to promptly condemn the unauthorized although not illegal act, and to seek judicial redress. Sheldon, etc., Co. *v.* Eickemeyer Hat Blocking Machine Co., 90 N. Y. 607, 614.'" See, also, Bond *v.* Manufacturing Co., 82 Tex. 309; s. c., 18 S. W. Rep. 691; Russell *v.* Railway Co., 68 Tex. 646; s. c., 5 S. W. Rep. 686; Stafford *v.* Harris, 82 Tex. 178; s. c., 17 S. W. Rep. 530. As to private corporations, having received the benefits of a contract beyond their power to make, being estopped to set up that excess of authority to excuse them from discharging their part of the contract, see De Groff *v.* American Linen Thread Co., (1860) 21 N. Y. 124; Sherman Center Town Company *v.* Fletcher, 46 Kans. 524; Town Co. *v.* Morris, 43 Kans. 282; s. c., 23 Pac. Rep. 569; Town Co. *v.* Swigart, 43 Kans. 292; s. c., 23 Pac. Rep. 569; Tootle *v.* First National Bank of Port Angeles, (1893) 6 Wash. St. 181; s. c., 33 Pac. Rep. 345; Heims Brewing Co. *v.* Flannery, (1891) 137 Ill. 309; Watts-Campbell Co. *v.* Yuengling, 51 Hun, 302; s. c., 3 N. Y. Supp. 869. The right to object to such contracts, or raise the question of *ultra vires:* Baker *v.* North Western Guaranty Loan Co., 36 Minn. 185; s. c., 30 N. W. Rep. 464; Starin *v.* Edson, 112 N. Y. 206; s. c., 19 N. E. Rep. 670. In Main *v.* Casserly, (1885) 67 Cal. 127, a corporation which had received and retained the consideration of a promissory note executed by it was held liable, although the note was executed in pursuance of a contract *ultra vires*.

[3] Humphrey *v.* Patrons, etc., Association, 50 Iowa, 607.

[4] Ibid.

to sell and convey all its corporate property, provided the sale be made for corporate or lawful purposes, and strangers taking a conveyance of such property have a right to assume, as against the corporation, that the sale was for a lawful purpose. And if the validity of such a sale be contested by the corporation on the ground that it was made for an unlawful purpose it would devolve upon the corporation to show that the party making the purchase knew of such unlawful purpose.[1] Even if unlawful for a corporation to make a sale of all its property to another corporation, and receive in payment therefor the stock of the grantee to be distributed among its own stockholders, if such sale is made, and the contract fully executed, the corporation itself cannot receive back the property sold or set aside the contract on account of its illegality.[2]

[1] Miners' Ditch Company *v.* Zellerbach, (1869) 37 Cal. 543.

[2] Ibid. SAWYER, Ch. J., said: "The term *ultra vires*, whether with strict propriety or not, is also used in different senses. An act is said to be *ultra vires* when it is not within the scope of the powers of the corporation to perform it under any circumstances or for any purpose. An act is also sometimes said to be *ultra vires* with reference to the rights of certain parties, when the corporation is not authorized to perform it without their consent; or, with reference to some specific purpose, when it is not authorized to perform it for that purpose, although fully within the scope of the general powers of the corporation, with the consent of the parties interested, or for some other purpose. And the rights of strangers dealing with corporations may vary according as the act is *ultra vires* in one or the other of these senses. All these distinctions must be constantly borne in mind in considering a question arising out of dealings with a corporation. When an act is *ultra vires* in the first sense mentioned it is generally, if not always, void *in toto*, and the corporation may avail itself of the plea. But when it is *ultra vires* in the second sense, the right of the corporation to avail itself of the plea will depend upon the circumstances of the case. The opinions in the cases below are extracted from freely to show the class of circumstances under which the plea of *ultra vires* would not be available to the corporation, to wit: Bissell *v.* Michigan Southern & Northern Indiana R. R. Cos., 22 N. Y. 262; Mayor of Norwich *v.* Norfolk Railway Company, 30 Eng. L. & Eq. 128; McGregor *v.* Dover & Deal Railway Co., 17 Jur. 21; s. c., 16 Eng. L. & Eq. 180; Simpson *v.* Denison, 10 Hare, 51; Simpson *v.* Denison, 13 Eng. L. & Eq. 359; Eastern Counties Railway Co. *v.* Hawkes, 35 Eng. L. & Eq. 9; Edwards *v.* Grand Junction Railway Co., 1 Myl. & Cr. 674; Treadwell *v.* Salisbury Manufacturing Co., 7 Gray, 393. Estoppel to plead *ultra vires:* Pauly *v.* Pauly, (Cal. 1895) 40 Pac. Rep. 29; Farmers' Loan & Trust Co. *v.* Toledo, A. A. & N. M. Ry. Co., (1895) 67 Fed. Rep. 49; Roy & Co. *v.* Scott, Hartley & Co., (Wash. 1895) 39 Pac. Rep. 679 (stockholders estopped); Central Building & Loan Association *v.* Lampson, (Minn. 1895) 62 N. W. Rep. 544 (one receiving the benefit of a loan estopped); Bensiek *v.* Thomas, (1895) 66

§ 280. When the doctrine of ultra vires is not applicable. — In an action against a corporation to recover money lost upon wagering contracts which the plaintiff had entered into through and with an agent of the corporation, the latter objected to a recovery against it on the ground that it was a corporation authorized to do a legitimate business, and that, as it could not lawfully authorize its agents to do an illegitimate business, it could not be bound by his acts in the prosecution of it; that the attempt to confer such authority would be *ultra vires*, and the attempted ratification of the agent's acts equally so. The Supreme Court of New York, in General Term, through LANDON, J., to this contention, said: "The position is untenable. A person, equally with a corporation, has no lawful power to do wrong; but both have the capacity to act, and the capacity to act amiss inheres in the capacity to act at all. Given the power and capacity to do right, the actor may nevertheless do wrong. Unless the actor is wholly irresponsible, he must answer for his wrong action, partly in justice to those injured thereby, and partly as a deterrent to its like repetition by himself and others. If the agents of a railroad corporation take my timber or iron against my consent, and convert it into a bridge, to the use of the corporation, the corporation must either restore my property or pay me for it. Here the defendant corporation has obtained the plaintiff's money. It was obtained by means of wager contracts. Confessing that it has the money, the defendant practically argues that, because it could not thus obtain it within its lawful powers, it does not really have it. Pretending to disclaim the transactions by which it obtained the money, it practically argues that its pretended disclaimer gives it title to keep the money. But, in truth, it cannot perfect its disclaimer of the transaction without surrendering its fruits; it cannot retain the money without adopting its agent's method of obtaining it; it cannot insist upon a defense so long as it refuses to qualify itself to interpose it. The doctrine of *ultra vires* is no wise applicable to the case." [1]

§ 281. Rules declared by courts as to estoppel of parties to contracts with corporations to plead ultra vires.—One

Fed. Rep. 104 (corporation estopped); Miller *v.* Washington Southern Ry. Co., (Wash. 1895) 39 Pac. Rep. 673 (corporation estopped).

[1] Peck *v.* Doran Wright Co. (Limited), (1890) 10 N. Y. Supp. 401.

who has received from a corporation the full consideration of his agreement to pay money cannot avail himself of the objection that the contract is *ultra vires*.[1] As corporations are created by public acts of the legislature, and all their powers, duties and obligations are declared and clearly defined by public law, parties dealing with them must take notice of those powers and the limitations upon them at their peril, and will not be allowed to plead ignorance of those powers and limitations in avoidance of the defense of *ultra vires*.[2] The defense that a corporation had no power under its charter to discount notes is not open in an action by the corporation against the maker upon a note discounted by the corporation for him at his instance.[3] Where a corporation indorses notes for another, and is compelled to pay them, in the absence of an express prohibition against such indorsements by the corporation, he for whose benefit the indorsement was made cannot invoke the plea of *ultra vires* as a defense against the enforcement of a chattel mortgage to secure the corporation against its liability upon the notes.[4] The defense cannot be made, in an

[1] Chicago & Atlantic Ry. Co. *v.* Derkes, (1885) 103 Ind. 520.

[2] Franklin Company *v.* Lewiston Institution for Savings, (1877) 68 Me. 43; citing Pearce *v.* Madison & Ind. Railroad, 21 How. 441; Andrews *v.* Insurance Co., 37 Me. 256. Parties receiving benefit of contract cannot insist that contract was *ultra vires*. Shelby *v.* Chicago & Eastern Illinois R. R. Co., (1892) 143 Ill. 335; s. c., 32 N. E. Rep. 438, affirming 42 Ill. App. 339.

[3] St. Joseph Fire & Marine Insurance Co. *v.* Hauck, (1880) 71 Mo, 465.

[4] St. Louis Drug Co. *v.* Robinson, (1881) 10 Mo. App. 587; affirmed in St. Louis Drug Co. *v.* Robinson, (1883) 81 Mo. 18, in which case the Supreme Court said: "Conceding that [the corporation had no authority to indorse notes for the accommodation of others] it is sufficient on this point to say that in a line of decisions of this court unbroken, except in the case of Matthews *v.* Skinker, 62 Mo. 329, it has been held that the question of *ultra vires* can only be raised in a direct proceeding by the state against the corporation, and not in a collateral proceeding by another, except when the charter of the corporation not only specifies, and, therefore, limits it to the business in which it may engage, but, by express terms, or by a fair implication from its terms, invalidates transactions outside of its legitimate corporate business. McIndoe *v.* St. Louis, 10 Mo. 577; Chambers *v.* St. Louis, 29 Mo. 543; Pacific R. R. Co. *v.* Seely, 45 Mo. 212; Land *v.* Coffman, 50 Mo. 243. Since Matthews *v.* Skinker, *supra*, was decided announcing a different doctrine, in the following cases this court returned to the doctrine of the earlier cases: A. & P. R. R. Co. *v.* St. Louis, 66 Mo. 228; St. Jos. Fire & M. Ins. Co. *v.* Hauck, 71 Mo. 465; Thornton *v.* National Ex. Bank, 71 Mo. 221; Union Nat. Bank *v.* Hunt, 76 Mo. 439. The judgment of this court in Matthews *v.* Skinker, *supra*, was on appeal reversed by the Supreme Court of the United States, and the doctrine then announced by that court is in

action by a corporation upon a contract made by it with the defendant, that the corporation, in making the contract, has exceeded the power conferred by its charter or the law under which it is formed.[1] The vendor to a corporation having power to purchase real estate, but prohibited by its charter from making purchases for other than a prescribed purpose, having made a deed to the corporation, cannot have the conveyance set aside and his contract rescinded on the ground that the corporation, in taking the conveyance, did so for a purpose other than that prescribed in its charter, and had exceeded its power.[2] The question whether, in such a case as this, the corporation has exceeded its powers, is one between the state and the corporation, with which a vendor, as a grantor simply of land to the corporation, has no concern.[3] An assignee of railroad stock, who had neither registered his stock nor obtained recognition as a stockholder, it has been held in a federal court, cannot bring suit in behalf of himself and other stockholders to restrain the action of the officers of the corporation from acts alleged to be *ultra vires* and illegal.[1] Where one buys land without knowledge of an outstanding equity, and his note, given for a portion of the price, secured by vendor's lien, is taken by a corporation to secure a loan, the owner of this outstanding equity cannot, in an action to enforce it, set up that the act of the corporation in taking the note was *ultra vires*.[2] A homestead loan association made a loan of money to two of its members for the use of a brewing company, the latter giving its deed of trust to the association to secure the loan. There was no fraud in the loan and nothing to mislead the parties in whose names the loan was made. The Illinois Supreme Court held that as the brewing company could not avoid its deed of trust under the plea of *ultra vires*, the parties to whom the loan was made were also estopped from availing of the defense, and that the deed of trust might be foreclosed as against them and other creditors of the brewing company having notice of the rights of the loan association.[3] It is no defense to a note given by one not a mem-

harmony with that which before had been uniformly, and has since been repeatedly, declared by this court." See, also, Franklin Ave. Ger. Sav. Inst. *v.* Board of Education, (1882) 75 Mo. 408; First National Bank *v.* Gillilan, (1880) 72 Mo. 77. It has been held in Brown *v.* Donnell, (1860) 49 Me. 421, an action against the maker by the indorsee of a note given to an insurance company and by the corporation transferred in payment of bank stock purchased by it, the maker of the note could not controvert the rights of the corporation to purchase the stock.

[1] Union Water Co. *v.* Murphy's Flat Fluming Co., (1863) 22 Cal. 621. It was said by the court: "In numerous cases it has been held that a contract made by a corporation which is not authorized by its charter is not to be held void, and that a defendant sued thereon cannot refuse payment; but the legislature may inquire into any violation of the charter, or the government may institute suit for that purpose. The investigation must be in a direct proceeding instituted by the government for that purpose, and it cannot be had in a collateral way by individuals. Grand Gulf Bank *v.* Archer, 8 Smedes & M. 151, 173; Wade *v.* American Colonization Society, 7 Smedes & M. 663; Nevitt *v.* Bank of Port Gibson, 6 Smedes & M. 513; Chester Glass Co. *v.* Dewey, 16 Mass. 102; Moss *v.* Rossie L. M. Co., 5 Hill, 140; The Banks *v.* Poitiaux, 3 Rand. 142, 146; Vidal *v.* Girard's Exrs., 2 How. 191; Fleckner *v.* U. S. Bank, 8 Wheat. 355; Natoma W. & M. Co. *v.* Clarkin, 14 Cal. 552.

[2] Hough *v.* Cook Land Co., (1874) 73 Ill. 23.

[3] Ibid.: citing Banks *v.* Poitiaux, 3 Rand. 141; Barrow v. N. & C. T. Co., 9 Humph. 304; Chambers *v.* St. Louis, 29 Mo. 576; Attorney-General *v.* Tudor Ice Co., 104 Mass. 239; Whitman Mining Co. v. Baker, 3 Nev. 391; Hayward *v.* Davidson, 41 Ind. 212. That the state alone can raise objection to an *ultra vires* act, see Alexander *v.* Tolleston Club of Chicago, (1884) 110 Ill. 65; Barnes *v.* Suddard, 117 Ill. 237; People's Gas, etc., Co. *v.* Chicago Gas, etc., Co., 20 Bradw. 473.

[1] Brown *v.* Duluth, M. & N. Ry. Co., (1893) 53 Fed. Rep. 889. See Heath *v.* Railway Co., 8 Blatchf. 347, 392, 410; Ramsey *v.* Erie Ry. Co., 7 Abb. Pr. (N. S.) 156; Hersey *v.* Veazie, 24 Me. 9.

[2] Taylor *v.* Callaway, (Tex. Civ. App. 1894) 27 S. W. Rep. 934. See, upon the question of estoppel to deny the power of a corporation to do an act, Bond *v.* Manufacturing Co., 82 Tex. 309; s. c., 18 S. W. Rep. 691, and authorities there cited, Bank *v.* Matthews, 98 U. S. 621; Smith *v.* White, (Tex. Civ. App.) 25 S. W. Rep. 809; Keys *v.* Association, (Tex. Civ. App.) 25 S. W. Rep. 809.

[3] Kadish *v.* Garden City Equitable Loan & Building Association, (1894) 151 Ill. 531. The court said: "There is * * * no prohibition in the statute against corporations becoming members of homestead loan associations for the purpose of borrowing money; neither is there any prohibition therein against loaning money for other than building purposes. In other words, the transactions were at most *ultra vires*, in the commonly understood sense of these words, and nothing more. As said in Whitney Arms Co. *v.* Barlow, 63 N. Y. 62, cited with approval by this court in Darst *v.* Gale, 83 Ill. 141, 'the acts were not immoral in themselves or forbidden by any statute, neither *mala in se* or *mala prohibita*, so as to make the contract illegal and incapable of being the foundation of an action. Such a contract as the law will not recognize or enforce, but applying the maxim *ex facto illicito non oritur actio*, leaves the parties as it found them.' It is also said in that case: 'When acts of corporations are spoken of as *ultra vires* it is not intended that they are unlawful or even such as the corporation cannot perform, but merely those which are not within the power conferred upon the corporation by the act of its creation, and are in violation of the trust reposed in the managing board by the stockholders, that the affairs shall be managed and the funds

ber of a building association for money loaned him that the corporation exceeded its powers in loaning the money for which the note was given.[1] In a Michigan case, a manufacturing corporation, outside of the purposes for which it was incorporated, contracted with a party for a stated quantity of a manufactured article at a certain price, and then made a contract with another to manufacture the same and deliver it to him at such a price as left a profit to the corporation. This contract was deemed an *ultra vires* contract, as being a contract purely for a speculative purpose, and the manufacturer bringing an action against the corporation on a *quantum meruit* for goods delivered under the contract, the corporation sought to recoup for damages by reason of non-performance of the contract. The Supreme Court held that the plaintiff was not estopped from claiming that the contract was *ultra vires*.[2] The court further held that there being noth-

applied solely for carrying out the object for which the corporation was created. * * * It is now very well settled that a corporation cannot avail itself of the defense of *ultra vires* when the contract has been in good faith performed by the other party, and the corporation has had the full benefit of the performance of the contract. * * * The same rule holds *e converso*. If the other party has had the benefit of the contract fully performed by the corporation he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation.'" See Benefit Association *v.* Blue, 120 Ill. 128; Bradley *v.* Ballard, 55 Ill. 415; 2 Beach on Priv. Corp. § 425 *et seq.*, for a full discussion of the subject; Carson City Sav. Bank *v.* Elevator Co., 90 Mich. 550; Holmes & Griggs Co. *v.* Metal Co., 127 N. Y. 252; s. c., 24 Am. St. Rep. 448.

[1] Poock *v.* Lafayette Building Association, (1880) 71 Ind. 357.

[2] Day *v.* Spiral Springs Buggy Co., (1885) 57 Mich. 146. Cooley, Ch. J., said: "[The parties to this contract] must, therefore, be supposed to have understood that the contract in its inception was *ultra vires*. And the power on the part of such a corporation to enter into contracts of speculation being withheld on reasons of public policy for the protection of shareholders and the general good of the community, the act neither of one party nor of both in entering into it can work an estoppel against setting up the invalidity. A rule of law established for the public good cannot be thus defeated. A corporation cannot, by the mere act of individuals, be given a power which the state, for general reasons, has withheld from it. Pennsylvania, etc., Nav. Co. *v.* Dandridge, 8 Gill & J. (Md.) 248, 319. Parties may also be estopped in some cases from disputing the validity of a corporate contract when it has been fully performed on one side, and when nothing short of enforcement will do justice. To quote the language of Comstock, Ch. J., in Parish *v.* Wheeler, 22 N. Y. 494, 508, 'the executed dealings of corporations must be allowed to stand for and against both the parties when the plainest rules of good faith so require.' But this is not such a case. The contract has only been performed in part. The defendant has received a portion of the property bargained for, and we may justly assume that what has been received has passed into the hands of [the vendee of the corporation] and been paid for, so that the defendant will lose nothing but the anticipated profits on the remainder if the contract is not enforced in its favor. Those profits it had no right at any time to count upon, and in contemplation of law there can be no injustice in depriving it of profits which the law would not permit it to bargain for. No valid ground for estoppel is, therefore, found to exist in the case."

ing of an immoral nature in this contract, the plaintiff was entitled to recover the value of her goods delivered on the contract to the corporation upon a *quantum meruit*.[1] If a corporation had no power to purchase a note and mortgage upon which it brings suit that fact should be pleaded as a defense.[2] Where one has made a contract with a corporation which is *ultra vires*, and has received the benefit of it, neither he nor those claiming under him are estopped from setting up the invalidity of the contract in defense of a suit to enforce it.[3]

§ 282. Financial arrangements contrary to public policy — rules governing proceedings on the part of the state, etc. —In proceedings on the part of the state to dissolve a corporation on account of its illegal or unwarranted acts, the state, as prosecutor, must show on the part of the corporation accused some sin against the law of its being which has produced or tends to produce injury to the public. The transgression must not be merely formal or incidental, but material and serious, and such as to harm and menace the public welfare. When the transgression threatens the welfare of the people, they may summon the

[1] Day *v.* Spiral Springs Buggy Co., (1885) 57 Mich. 146. The ruling the court considered sustained by Pratt *v.* Short, 79 N. Y. 437; Northwestern Union Packet Co. *v.* Shaw, 37 Wis. 655, and Harriman *v.* Baptist Church, 63 Ga. 186, and cited as cases considering the principle involved, Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; Thomas *v.* Railroad Co., 101 U. S. 71; In re Cork & Y. Ry. Co., L. R., 4 Ch. App. 748; In re National, etc., Society, L. R., 5 Ch. App. 309.

[2] Thomson *v.* Madison Building & Aid Association, (1885) 103 Ind. 279.

[3] Chambers *v.* Falkner, (1880) 65 Ala. 448. In Marion Savings Bank *v.* Dunkin, 54 Ala. 471, Justice Stone of the Alabama Supreme Court has said: "A party dealing with a corporation, in a matter not within the purview of its delegated powers, does not estop himself from setting up in defense the want of authority in the corporation to make the contract * * *. In such case the doctrine of estoppel cannot be held to apply without clothing corporations with the ability to increase their powers indefinitely by sheer usurpation. Such contracts on the part of a corporation are *ultra vires* and void, and no right of action can spring out of them."

offender to answer for the abuse of its franchise or the violation of its corporate duty. These are the rules declared by the Court of Appeals of New York when considering the people's case against a corporation organized under the statutes of that state for the formation of manufacturing corporations which had surrendered its stock under an agreement with other similar corporations for the purpose of forming a "trust."[1] By the agreement entered into by the corporation immediately involved in the case with the others concerned, a "board," as it was called, was formed. The signers agreed to transfer all their shares of stock "to the names of the board as trustees, to be held by them and their successors as members of the board strictly as private tenants." This board, it was declared, "shall hold the stock transferred to it with all the rights and powers incident to stockholders in the several corporations." It was also authorized to transfer "to such persons as it may be desired to constitute trustees or directors or other officers of corporations so many of the shares as may be necessary for that purpose." The agreement provided that certificates should be issued by the "board" to the contracting parties in specified proportions in lieu of the capital stock; that each of the parties should maintain a separate organization and carry on and conduct its own business, paying over the profits to the board, "the aggregate or such amount as shall be designated for dividends," to be proportionally distributed by the board to the holders of the certificates. The board was prohibited from taking any action "which shall create liability by it or by its members," but there was a provision that the funds necessary to enable the board to make payments as specified "may be raised by mortgage to be made by the corporations, or any, either or all of them, upon their property." The number and amount of shares to be issued by the board was fixed with a proviso that they "may from time to time be increased or diminished by deeds executed by a majority in value of the certificate holders." Defendant's stock was transferred and certificates issued to its stockholders as provided for. The board elected officers and board of trustees of defendant, having transferred to each of them a share of the stock to enable him to hold the office. The effect of this transaction, as far as concerned defendant, was stated by the court to be "to divest it of the essential and vital

[1] People *v.* North River Sugar Refining Company, (1890) 121 N. Y. 582.

elements of its franchise by placing them in trust; to accept from the state the gift of corporate life only to disregard the conditions upon which it was given; to receive its powers and privileges merely to put them in pawn, and to give away to an irresponsible board its entire independence and self-control. When it had passed into the hands of the trust only a shell of a corporation was left standing, as a seeming obedience to the law, but with its internal structure destroyed or removed. Its stockholders, retaining their beneficial interest, have separated from it their voting power and so parted with the contract which the charter gave them and the state required them to exercise. It has a board of directors nominally and formally in office, but qualified by shares which they do not own, and owing their official life to the board which can end their power at any moment of disobedience. It can make no dividends, whatever may be its net earnings, and must incumber its property at the command of its master and for purposes wholly foreign to its own corporate interests and duties." "In all these respects," said the court, "it has wasted and perverted the privileges conferred by the charter, abused its powers and proved unfaithful to its duties. But graver still is the illegal action substituted for the conduct which the state had a right to expect and require. It has helped to create an anomalous trust, which is, in substance and effect, a partnership of twenty separate corporations. The state permits in many ways an aggregation of capital, but, mindful of the possible dangers to the people overbalancing the benefits, keeps upon it a restraining hand, and maintains over it a prudent supervision where such aggregation depends upon its permission and grows out of its corporate grants. It is a violation of law for corporations to enter into a partnership."[1] Referring later in their opinion to this trust formed by the several corporations, having a capital stock double the value of the fair aggregate value of the rights and franchises of the companies absorbed at the outset and capable of an elastic and irresponsible increase, the court said: "And here, I think, we gain a definite view of the injurious tendencies developed by its organization and operation and of the public interests which are menaced by its action. As corporate grants are always assumed to have been made for the

[1] Ibid.; citing N. Y. & S. C. Co. *v.* Meredith, 1 Wall. 29; Whittenton F. Bank, 7 Wend. 412; Clearwater *v.* Mills *v.* Upton, 10 Gray, 596.

public benefit, and conduct which destroys their normal functions and maims and cripples their separate activity and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest, and that to a much greater extent when beyond their own several aggregations of capital they compact them all into one combination, which stands outside of the hand of the state, which dominates the range of an entire industry and puts upon the market a capital stock, proudly defiant of actual values, and capable of an unlimited expansion."[1] If the business of a corporation is threatened with competition, it is not illegal or immoral if it can persuade its competitor to abandon an enterprise in which both cannot succeed upon the basis of some proper consideration therefor.[2] In an Ohio case the Supreme Court said: "Where all or a majority of the stockholders comprising a corporation do an act which is designed to affect the property and business of the company, and which, through the control their numbers give them over the selection and conduct of the corporate agencies, does affect the property and business of the company in the same manner as if it had been a formal resolution

[1] People *v.* North River Sugar Refining Co., (1890), 121 N. Y. 582, holding that the corporation had violated its charter and failed in the performance of its corporate duties, and in respects so material and important as to justify a judgment of dissolution. In Leslie *v.* Lorillard, (1888) 110 N. Y. 519, 533, the New York Court of Appeals said: "Corporations are great engines for the promotion of the public convenience and for the development of public wealth, and so long as they are conducted for the purposes for which organized, they are a public benefit; but if all were to engage without supervision in subjects of enterprise foreign to their charters, or if permitted unrestrainedly to control and monopolize the avenues to that industry in which they are engaged, they become a public menace, against which public policy and statutes design protection. When, therefore, the provisions of agreements in restraint of competition tend beyond measures for self-protection and threaten the public good in a distinctly appreciable manner, they should not be sustained. The apprehension of danger to the public interests, however, should rest on evident grounds, and courts should refrain from the exercise of their equitable powers in interfering with and restraining the conduct of the affairs of individuals or of corporations, unless their conduct, in some tangible form, threatens the welfare of the public." See on this subject Shepaug Voting Trust Cases, (1890) 60 Conn. 553; s. c., 24 Atl. Rep. 32.

[2] Oakes *v.* Cattaraugus Water Company, (1894) 143 N. Y. 430; s. c., 38 N. E. Rep. 461; 62 N. Y. St. Repr. 445. See, also, Leslie *v.* Lorillard, (1888) 110 N. Y. 519.

of its board of directors; and the act so done is *ultra vires* of the corporation and against public policy, and was done by them in their individual capacity for the purpose of concealing their real purpose and object, the act should be regarded as the act of the corporation, and, to prevent the abuse of corporate power, may be challenged as such by the state in a proceeding in *quo warranto*."[1] THAYER, J., in the United States Circuit Court for the eastern district of Missouri, refused an injunction to restrain a Missouri corporation from violating an agreement it had entered into not to engage in the business for which it was organized for a period of twenty-five years upon the ground that the agreement was void. He referred to the trust agreement which had been signed by this and other corporations in the same line of business, its various provisions, and held that this corporation exceeded its powers in signing and becoming a party to the trust agreement.[2] These are rules declared by the New Jersey Court of Chancery: The corporate acts of directors, if they are within the powers of the corporation, and in furtherance of its purposes are not unlawful or against good morals and are done in good faith and in the exercise of an honest judgment, cannot be questioned by individual stockholders in judicial proceedings. Contracts made by corporations, which appear to be designed to promote their legitimate and profitable operation, will be presumed by the courts, as a general rule, to be within

[1] State ex rel. *v.* Standard Oil Company, (1892) 49 Ohio St. 137.

[2] In American Preservers' Trust *v.* Taylor Manufg. Co., (1891) 46 Fed. Rep. 152, it was said by the court: "By [signing and becoming a party to this agreement defendant] united, with the other corporations and individuals who signed the agreement, in creating a partnership or joint-stock concern, and in furtherance of that enterprise it undertook to appoint agents to manage the concern in its behalf, and to vest such agents with authority to buy and lease property in all parts of the United States, to obtain and exercise control over other corporations by acquiring their stock, and with power likewise to issue negotiable securities without limit, and to declare dividends thereon. In all these respects, I must conclude that the defendant corporation, by executing the trust agreement, undertook to exercise powers to which it could lay no reasonable claim by virtue of the law under which it is organized, and from which all of its powers are derived." Citing People *v.* North River Sugar Refining Co., (1890) 121 N. Y. 582; s. c., 24 N. E. Rep. 834; Mallory *v.* Hanaur Oil Works, (1888) 86 Tenn. 598; s. c., 8 S. W. Rep. 396; State *v.* Nebraska Distilling Co., (1890) 29 Neb. 700; s. c., 46 N. W. Rep. 155; Whittenton Mills *v.* Upton, 10 Gray, 596.

the limits of their power, and if the validity of the contracts be assailed, the assailant will be required to assume the burden of demonstrating their invalidity. Corporations organized under the general law of New Jersey are vested with the powers conferred by the general act, and those contemplated by the certificate, and such incidental powers, with respect of the general and special powers, as are necessary in the sense of convenient, reasonable and proper. While the general act permits incorporation for "any lawful business or purpose whatsoever," and the law gives all necessary powers thereto, it does not recognize as embraced therein powers to do those things which would deprive the corporation of its ability to carry out the objects for which it was formed, or discharge any duties which it might under its charter owe to the public, or which are contrary to the policy of the law.[1] The doctrine of *ultra vires* ought to be reasonably, and not unreasonably, understood and upheld, and whatever may be fairly regarded as incidental to and consequential upon those things which are authorized by the charter of a corporation ought not, unless expressly prohibited, to be held by judicial construction to be *ultra vires*.[2] Contracts by a corporation which impose an unreasonable restraint upon the exercise of its business are void, but contracts in reasonable restraint of its business are valid. The test to be applied in determining the reasonableness of the restraint imposed by the contract is to consider whether it is only such as is necessary to afford a fair protection to the interest of the corporation in favor of which it is given, and not so large as to interfere with the interest of the public.[3] The Illinois Supreme Court, in the Chicago Gas Trust case, declared these rules as to corporations: Corporations can only exercise such powers as may be conferred by the legislative body creating them, either in express terms or by necessary implication, and the implied powers are presumed to exist to enable such bodies to carry out the express powers granted, and to accomplish the purposes of their

[1] Ellerman *v.* Chicago Junction Railways & Union Stock Yards Company, (1891) 49 N. J. Eq. 217.

[2] Ibid.

[3] Ibid.; in which case, under the test stated in the text, the chancellor held that a covenant by parties selling the plant and business of stock yards, not to engage in the business for a certain number of years, nor in the place where they were located or within 200 miles thereof, was not unreasonable, and not an illegal restraint of trade. For illustration of contract between corporations not contrary to public policy, see Live Stock Assn. of New York *v.* Levy, (1886) 54 N. Y. Super. Ct. 32.

creation.[1] An incidental power is one that is directly and immediately appropriate to the execution of the specific powers granted, and not one that has a slight or remote relation to it.[2] The court held that the Chicago Gas Trust Company, being a corporation formed under the General Incorporation Law of that state for the purpose of erecting and operating gas works and the manufacture and sale of gas, had no power to purchase and hold or sell shares of stock in other gas companies as incident to the purpose for which it was formed, even though such power was specified in its articles of incorporation. This corporation was incorporated under the general law for two purposes. These were expressed in its articles of association in these words: *First*, for the purpose of erecting and operating gas works for the manufacture and sale of gas in Chicago and other places in this state; and, *second*, "to purchase and hold or sell the capital stock, or purchase or lease, or operate the property, plant, good will, rights and franchises of any gas works or gas company or companies, or any electric company or companies, in Chicago or elsewhere, etc." It sought to exercise the powers claimed under the second clause only, and for that purpose bought a majority of the shares of all the gas companies in Chicago, being four in number, whereby it might have the control of all the gas companies in the city and thus destroy competition and monopolize the gas business. The Supreme Court held that the corporation so formed was not for a lawful purpose and that all acts done by it toward the accomplishment of such object were illegal and void.[3] A stockholder, in a suit which he is only permitted to prosecute in behalf of the corporation and for its benefit, cannot raise the question whether or not the defendant corporation in the suit could acquire and lawfully exercise all the powers declared in its certificate of incorporation, especially whether it could lawfully own the stock of another corporation. Such a question can only be presented for judicial determination by the attorney-general on behalf of the state.[4]

[1] Citing C., P. & S. W. R. R. Co. *v.* Marseilles, 84 Ill. 643; Chicago Gas Light Co. *v.* People's Gas Light Co., 121 Ill. 530.

[2] People ex rel. Peabody *v.* Chicago Gas Trust Co., (1889) 130 Ill. 268; s. c., 22 N. E. Rep. 798; citing on the last point Hood *v.* N. Y. & N. H. R. R. Co., 22 Conn. 1; Franklin Co. *v.* Lewiston Savings Institution, 68 Me. 43.

[3] People ex rel. Peabody *v.* Chicago Gas Trust Co., (1889) 130 Ill. 268; s. c., 22 N. E. Rep. 798.

[4] Willoughby *v.* Chicago Junction Railways & Union Stock Yards Co., (1892) 50 N. J. Eq. 656.

CHAPTER IX.

BANKS AND BANKING.

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§ 283. Powers of banks generally.— A bank, upon which general banking powers have been conferred, may borrow money without any more specific authority.[1] A national bank has power to borrow money on negotiable paper, made and indorsed for its accommodation.[2] As incident to its power to loan money, a bank may take as security a crop of cotton, and ship the same to a factor, to be sold to reimburse the loan.[1] A bank, authorized by its charter to deal in bills of exchange and discount notes, made negotiable and payable at the bank, with two or more good and sufficient sureties, may, under this power, undertake to collect bills of exchange in other places.[2] Under the National Banking Association Act, the powers which national banks may exercise are limited to those expressly granted and those necessarily incidental.[3] They would have no absolute right to retain bonds coming into their possession by purchase, under contracts which they were without legal authority to make.[4] National banks may exercise all such incidental powers as may be necessary for discounting and negotiating promissory notes, drafts, bills of exchange, etc., which they are authorized to do.[5] It is not beyond the powers of a national bank to purchase a draft

[1] Ringling *v.* Kohn, (1878) 6 Mo. App. 333; Donnell *v.* Lewis Co. Savings Bank, 80 Mo. 165.

[2] Bank *v.* Sullivan, 11 W. N. C. (Pa.) 362. In a leading New York case (Curtis *v.* Leavitt, (1857) 15 N. Y. 9, 255, 256), SELDEN, J., states the contention of the receiver's counsel as follows: "[They] take the broad ground that banking corporations cannot borrow money, or, at least, that they cannot borrow to supply the place of capital. They contend that it is the business of banks to lend money, not to borrow; that borrowing does not come within the scope of legitimate banking, and is in its nature a power which corporations created for banking purposes cannot properly exercise." He then said: "This position is not supported by any direct authority, and a careful consideration of the nature of banking, together with an examination of its history, has satisfied me that it cannot be sustained. It is not in harmony with the present practice or the past history of banks. Banking for profit is based primarily upon the idea of borrowing, without interest, the various sums which the individuals of a commercial community must necessarily keep on hand unemployed, to meet any sudden emergency, and re-loaning the money, or the greater part of it, upon interest. It may be said that banks may borrow, that is, receive deposits without interest, but cannot borrow upon interest. This, too, is untenable. One of the soundest banking systems known to the age, viz., the Scotch, is sustained to a great extent by sums borrowed at a rate of interest below that charged by the banks. Edin. Ency. 224, tit. Banks; Lawson's Hist. of Banking, 419. The committee appointed by the House of Lords in England, in 1826, to inquire into the Irish and Scotch systems of banking, reported that it was 'proved by evidence and by the documents that the banks of Scotland, whether chartered joint-stock companies or private establishments, have, for more than a century, exhibited a stability which the committee believe unexampled in the history of banking.' Lawson's Hist. of Banking, 434. The country bankers of England also allow interest on the balances of money in their hands. McCulloch's Notes to Smith's Wealth of Nations, 489, title, Money, Edin. ed.; Lawson's Hist. of Banking, 273. Another writer, speaking of the practice of borrowing by the Scotch banks, says: 'This is in fact a part of the proper business of a bank. A banker is a dealer in capital, an intermediate party between the borrower and the lender; he borrows of one party and lends to another, and the difference between the terms at which he borrows and those at which he lends is the source of his profit.' Gilbert on Banking, 52. It can scarcely be said, in view of these precedents and authorities, that borrowing money, even to be used as capital, is not within the range of the business of banking. The position, therefore, that the acts of the banking company in issuing the paper in question were *ultra vires* cannot be sustained on the ground that borrowing is no part of legitimate banking, but must rest on that branch of the argument which is drawn from the terms of the General Banking Law itself. It is a question, not of appropriate banking, but of corporate power."

[1] Deloach *v.* Jones, 18 La. 447.

[2] Branch Bank at Montgomery *v.* Knox, (1840) 1 Ala. 148. As to the power of banks to issue post notes, see Campbell *v.* Mississippi Union Bank, 6 How. (Miss.) 625.

[3] Logan Bank *v.* Townsend, 139 U. S. 67.

[4] Ibid.

[5] Shinkle *v.* First National Bank of Ripley, (1872) 22 Ohio St. 516.

with a bill of lading attached.[1] The discount of notes by a corporation authorized by statute to invest its capital in notes and to purchase and hold securities in payment of the debts due to it is not *ultra vires*.[2] A banking institution, having power to lend deposits on the public stock of the state or the United States on bond and mortgages, or "upon any other securities which should be deemed, by the board of directors, ample," has been held not to be limited to the securities mentioned, and empowered to discount commercial paper.[3] A national bank, having coin in pledge, may sell and assign its special property therein.[4] A bank, to save itself from loss, under its general powers, may take an assignment of an account due its debtor.[5] A national bank is authorized to buy the checks of individuals or other banks, when payable to bearer or to order.[6] A bank may transfer a good title to checks received, as cash, from a depositor, and so credited to his account, in payment of a debt, and the transferee may recover upon them against the drawers.[7] A bank, with which an owner of a bond and mortgage had agreed to convert it into money for the benefit of the bank, and upon its assignment for that purpose, had guaranteed its collection, was held bound by the guaranty, although the bond was not assigned to the bank, and reassigned by it.[8] A national bank may take, hold and enforce a chattel mortgage for a previously contracted debt.[9] It is within the powers conferred by congress upon national banking associations to receive from its customers United States bonds of one class to be converted into bonds of another class.[10] A bank, without an express undertaking on its part, will not be bound, by law, to protect from forfeiture, stock deposited with it as security for a debt, by payment of installments in arrear.[11] The Minnesota Supreme Court has held that there is no reason

[1] Union National Bank *v.* Rowan, 23 S. C. 342.

[2] Bright *v.* Banking Co., 3 Pennypacker (Pa.), 478.

[3] Detroit Savings Bank *v.* Truesdail, 38 Mich. 430.

[4] Merchants' Bank *v.* State Bank, 10 Wall. 604.

[5] Bank of North America *v.* Tamblyn, (1879) 7 Mo. App. 571.

[6] Rochester Bank *v.* Harris, (1871) 108 Mass. 514.

[7] Metropolitan National Bank *v.* Loyd, (1881) 25 Hun, 101.

[8] Talman *v.* Rochester City Bank, (1854) 18 Barb. 123.

[9] Spafford *v.* First National Bank of Tama City, 37 Iowa, 181.

[10] Leach *v.* Hale, (1870) 31 Iowa, 69.

[11] Railroad Bank *v.* Douglas, 2 Speer (S. C.), 329.

why a national bank may not, for convenience and a proper purpose, hold and own notes and mortgages through the medium of a trustee.[1]

§ 284. The guaranty of commercial paper by a bank.—The Supreme Court of Nebraska has lately held that while a national bank may not lend its credit for the accommodation of others, still it may guarantee the payment of commercial paper as incidental to the exercise of its power to buy and sell the same.[2] The Nebraska court accepted as the proper statement of the law upon this subject the following declaration by Mr. Justice SWAYNE, speaking for the United States Supreme Court, in a leading case before that court: "The National Bank Act,[3] gives every bank created under it the right to exercise by its board of directors, or duly authorized agents, all such incidental powers as shall be necessary to carry on the business of banking, *by discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt*, by receiving deposits, etc. Nothing in the act explains or qualifies the terms italicized. To hand over with an indorsement and guaranty is one of the commonest modes of transferring the securities named. Undoubtedly a bank might indorse 'waiving demand and notice,' and would be bound accordingly. A guaranty is a less onerous and stringent contract than that created by such an indorsement. We see no reason to doubt that, under the circumstances of this case, it was competent for the defendant to give the guaranty here in question. It is to be presumed the vice-president had rightfully the power he assumed to exercise, and the defendant is estopped to deny it. Where one of two innocent parties must suffer by the wrongful act of a third, he who gave the power to do the wrong must bear the burden of the consequence. The doctrine of *ultra vires* has no application in cases like this. Merchants' Bank *v.* State Bank, 10 Wall. 604. All the parties engaged in the transaction, and the privies, were agents of the defendant. If there were any defects of authority on their part, the retention and enjoyment of the proceeds of the transaction by their principal constituted an acquiescence as effectual as

[1] First National Bank of Memphis *v.* Kidd, 20 Minn. 234.

[2] Thomas *v.* City National Bank of Hastings, (1894) 40 Neb. 501; s. c., 58 N. W. Rep. 943.

[3] Rev. St. U. S. § 5136.

would have been the most formal words. These facts conclude the defendant from resisting the demand of the plaintiff. * * * A different result would be a reproach to our jurisprudence."[1]

§ 285. Acts ultra vires a bank.— A bank discounting a note, knowing the intention of the party offering it to be that the proceeds of the discounting should be applied to the discharge of a particular note held by the bank, cannot apply the proceeds to the discharge of any other note.[2] A bank cannot bind itself by an accommodation indorsement.[3] National banks have no legal power to guarantee a contract between other persons for the delivery of building materials.[4] The power of a national bank to give a guaranty against liability or loss to sureties on paper discounted by it, when the effect of such guaranty would be to make the paper that of one party only, secured by mortgages on real estate, has been questioned in a Michigan case.[5] A national bank cannot act as broker for the sale of state bonds on commission.[6] A national bank has no power to sell railroad bonds for a customer on commission.[7] A bank has no authority to become surety on the bond of a public officer.[8] A bank will not be justified in refusing to reassign collateral which it holds for the payment of certain notes because the pledgee may be indebted to it upon an entirely distinct cause of action.[9] A bank cannot apply the proceeds of a note tendered to it for discount to the

[1] People's Bank *v.* Manufacturers' National Bank, 101 U. S. 181, in which case the facts were that one Pickett made his notes for $50,000, payable to his own order, indorsed them, and delivered them to the national bank to be negotiated to the plaintiff. The vice-president of the national bank, with the knowledge and consent of the president and cashier, but without any authority from the board of directors, or from a majority of them as individuals, transmitted the notes to the plaintiff, with a written guaranty signed by himself. The plaintiff's account was debited with $50,000 on account of the notes. At the same time Pickett's paper held by the defendant was canceled to the same amount.

[2] Bank of Alexandria *v.* Saunders, 2 Cranch Cir. Ct. 183.

[3] Bank of Genesee *v.* Patchin Bank, 13 N. Y. 309.

[4] Norton *v.* Derry National Bank, 61 N. H. 589.

[5] First National Bank *v.* Bennett, 33 Mich. 520.

[6] Smith *v.* Bank, 1 Walk. (Pa.) 318.

[7] Weckler *v.* First National Bank of Hagerstown, 42 Md. 581.

[8] Miners' Bank Estate, 13 W. N. C. (Pa.) 370.

[9] McIntire *v.* Blakeley, (Pa.) 12 Atl. Rep. 325.

payment of the maker's indorsement on another note without his consent.[1] In an action of the owner of a lot which had been assessed by a city for benefits and afterwards sold upon a judgment, and a certificate of sale given to the city, which it assigned to another party, who in turn assigned it to a national bank, against the city and bank to determine their adverse claims, the plaintiff made the point that the bank, being a national bank, had no authority to purchase the certificate. The Supreme Court of Minnesota considered it well settled that no one but the government could raise that question.[2] The United States Circuit Court for the eastern district of Washington, in an action upon a note against a national bank as guarantor, has held that United States Revised Statutes, section 5202, providing that national banks shall not contract liabilities in excess of their paid-up capital stock, except upon notes of circulation, accounts for deposits, etc., did not intend that such items of liability should be excluded in determining whether the indebtedness of a bank exceeded its paid-up capital stock at the time it incurred a liability as guarantor. And that in an action against the bank and its receiver on such a note as here sued on, the defendants might avail themselves of the defense that the note was executed in violation of the section of the Revised Statutes above mentioned, as the note being void as to the bank, it was not estopped to set up the defense in question.[3]

§ 286. Taking mortgage on and purchase of real estate. — A national bank cannot take a mortgage upon real estate as a security for a debt concurrently created, or for future advances.[4] It is competent for a national bank to purchase a note in favor of a third party, and thereby acquire incidentally a mortgage on

[1] Parry *v.* Highley, 8 Pa. Co. Ct. Rep. 584.

[2] Hennessy *v.* City of St. Paul, (1893) 54 Minn. 219; s. c., 55 N. W. Rep. 1123; citing Merchants' National Bank *v.* Hanson, 33 Minn. 40; s. c., 21 N. W. Rep. 849; National Bank *v.* Matthews, 98 U. S. 621; National Bank *v.* Whitney, 103 U. S. 99; Fortier *v.* New Orleans Bank, 112 U. S. 451; s. c., 5 Sup. Ct. Rep. 234.

[3] Weber *v.* Spokane Nat. Bank, (1892) 50 Fed. Rep. 735.

[4] Kansas Valley National Bank *v.* Rowell, (1873) 2 Dill. 371. As to the lack of power of a national bank to loan its money on real estate security, see Matthews *v.* Skinker, (1876) 62 Mo. 329; Warner *v.* DeWitt County National Bank, 4 Bradw. (Ill.) 305; Winton *v.* Little, 94 Pa. St. 64, overruling Fowler *v.* Scully, 72 Pa. St. 456, and Woods *v.* People's Bank, 83 Pa. St. 57; National Bank *v.* Matthews, 98 U. S. 621; National Bank *v.* Whitney, 103 U. S. 99; Fortier *v.* New

land which may have been given to secure it.[1] Where several debts due a national bank are consolidated into one, and a new note given, the bank would not be acting *ultra vires* in taking a mortgage on real estate to secure the consolidated note.[2] A national bank extended the time of payment of indebtedness secured by a mortgage on real estate at a usurious rate of interest, and took for it notes and a mortgage, made by the debtor to a third person, the notes being indorsed by the latter. The Supreme Court of Ohio held that the usury only avoided the interest, and that to the extent the debt was valid, the mortgage was on *bona fide* security, and that the bank, by becoming the owner of the notes, acquired the equity in the mortgage.[3] A mortgage upon real estate given to an officer of a national bank, at the time of a loan by the bank, to secure its payment, being, in effect, the same as if made to the bank, has been held to be void and not enforceable by the courts, under the prohibition in the National Banking Law, of loans of money on real estate security.[4] The prohibition in the law against national banks taking security for loans on real estate, does not, however, extend to mortgages made in good faith by way of security for debts previously contracted, and banks may take the assignment of notes, secured by trust deed on real estate, as collateral security for pre-existing debts due the banks.[5] A national banking association may avail itself of a security on real estate given to one personally liable on a loan made by the association.[6] The Minnesota Supreme Court has

Orleans National Bank, 112 U. S. 439. For an illustration of a note and mortgage on real property which it was in the power of a national banking association to take, see Ornn *v.* Merchants' National Bank, (1876) 16 Kans. 341.

[1] Oldham *v.* Bank, 85 N. C. 240.

[2] Ibid.

[3] Allen *v.* First National Bank Xenia, (1872) 23 Ohio St. 97.

[4] Fridley *v.* Bowen, (1877) 87 Ill. 151. The court said: "The provision [of the National Banking Law] declaring upon what security such associations may make current loans, viz.: Upon 'personal security,' and the subsequent inhibition that no mortgage shall be taken on real estate except by way of security for debts previously contracted, must be understood to forbid absolutely such associations making loans upon security afforded by mortgages on real estate." The court cited as sanctioning its views: Fowler *v.* Scully, 72 Pa. St. 456; First National Bank *v.* National Bank, 92 U. S. 122; Matthews *v.* Skinker, 62 Mo. 329.

[5] Worcester National Bank *v.* Cheeney, (1878) 87 Ill. 602; Gaar *v.* First National Bank of Centralia, 20 Bradw. (Ill.) 611.

[6] First National Bank *v.* Haire, 36 Iowa, 443. As to a national bank's right to take title to real estate in discharge of indebtedness previously contracted to it, see Turner *v.* First National Bank, (1881) 78 Ind. 19. As to a mortgage given to a national bank and assigned to a third party being good, see Lacey *v.* Central National Bank, 4 Neb. 179. As to foreclosure of a mortgage by a national bank, see Scofield *v.* State National Bank, 9 Neb. 323.

held that, in the absence of affirmative evidence of some contravention of the National Banking Association Act, a national bank might lawfully purchase, hold and convey real estate.[1] The New Jersey Supreme Court has held that a national bank empowered by its charter "to provide the real estate" necessary for its immediate accommodation in the transaction of its business, cannot interpose the defense of *ultra vires* to a contract made by it to secure free entrance of light and air into its banking house.[2] Where a national bank discounts a note secured by a deed of trust on real estate, the security passes to the bank and may be enforced by it.[3] Speculation in real estate, by national banks, under the pretense of obtaining satisfaction of a previous debt, is forbidden by law. Such a bank, however, may acquire title to real estate, even though incumbered, if it is honestly done, for the purpose of securing a debt due to it. This may be done by taking a conveyance directly or by sale under process of law.[4] Thus, where a firm of merchants were indebted to a bank upon drafts drawn upon them and accepted, discounted by the bank, in its regular course of business, to a certain amount, and secured by the transfer of a note of a third party for a larger sum, this note secured by a deed of trust upon real estate subject to other liens, and the third party made a deed of the property to the bank in payment of the sum due from him, the bank agreeing to discharge the other liens upon the same, the transaction was held not to be forbidden by the law regulating such banks.[5] A mortgage upon real property taken by a national banking association as security will not be void. A judgment of onster and dissolution in a proper proceeding is the punishment for taking such a mortgage. Private persons cannot question the validity of the act.[6] A national bank may purchase real

[1] First National Bank of Memphis *v.* Kidd, 20 Minn. 234.

[2] Trustees of First Presbyterian Church in Newark *v.* National State Bank of Newark, (N. J. 1894) 29 Atl. Rep. 320.

[3] Thornton *v.* National Exchange Bank, (1879) 71 Mo. 221.

[4] Mapes *v.* Scott, (1878) 88 Ill. 352.

[5] Ibid.

[6] First National Bank *v.* Elmore, 52 Iowa, 541; Streeter *v.* First National Bank, 53 Iowa, 177. As to the power of a national bank to purchase real

estate at a judicial sale to satisfy a judgment and decree rendered in a proceeding to foreclose a mortgage on land on which the bank held a second mortgage lien, and to which foreclosure proceeding it was made a party.[1] These banks have authority to hold and convey such real estate as they may purchase at sales under judgments, decrees or mortgages held by them to secure debts due them.[2] The title of a national bank to land which was mortgaged to it, and purchased at judgment sale, would not be invalidated as to the mortgaged property, by the fact that at the sale it purchased other property which it may not have been authorized to acquire.[3]

§ 287. Purchasing notes.—The Court of Appeals of Maryland has held that under the National Banking Association Act a bank formed under it has no authority to use its funds in purchasing notes and can acquire no title to notes by the purchase of them.[4] The ruling of the Minnesota Supreme Court on this subject has been that the purchase of promissory notes by a bank authorized simply to discount notes was *ultra vires* and that the purchase would confer no title.[5] In a later case this same court held that national banks have no power to deal in promissory notes, as choses in action, for the purpose of private gain and profit alone, and limited their power to acquire title to such notes

estate necessary to secure a debt to it, although in excess of the debt, see Upton *v.* South Reading Bank, (1876) 120 Mass. 153.

[1] Heath *v.* Second National Bank, (1880) 70 Ind. 106.

[2] Wherry *v.* Hale, (1882) 77 Mo. 20. As to a national bank purchasing real estate in satisfaction of a debt due it, see Libby *v.* Union National Bank, 99 Ill. 622.

[3] Reynolds *v.* Crawfordsville Bank, 112 U. S. 405. As to a national bank, lawfully holding a mortgage on real estate, purchasing a prior mortgage on the same land to protect its interest, see Holmes *v.* Boyd, (1883) 90 Ind. 332.

[4] Lazear *v.* National Union Bank of Maryland, at Baltimore, (1879) 52 Md. 78.

[5] Farmers & Mechanics' Bank *v.* Baldwin, 23 Minn. 198. The court said: "The power to carry on the business of banking by discounting notes, bills and other evidences of debt, is only an authority to loan money thereon, with the right to deduct the legal rate of interest in advance. This right can be fully enjoyed without the possession of the unrestricted power of buying and dealing in such securities as choses in action and personal property. Though, as argued by plaintiff, the bank acquires a title to discount paper, and, hence, may, in a certain sense, be said to have purchased it, yet it is a purchase by discount, which is permitted, and does not involve the exercise of a power of purchase in any other way than by discount."

to discounting them.[1] In an Ohio case it was held that the power given to the corporation by a statute of the state of New York "to carry on the business of banking by discounting bills, notes and other evidences of debt," was not a power to buy promissory notes but to loan money upon the paper described, and that a transaction of that character was within the usury laws of that state.[2] Under the power given savings institutions to discount negotiable notes in Kansas, they have been held to have the power of purchasing such notes.[3] In a comparatively late

[1] First National Bank of Rochester *v.* Pierson, 24 Minn. 140.

[2] Bank *v.* Baker, 15 Ohio St. 68. In Fleckner *v.* Bank, 8 Wheat. 338, it appeared that the plaintiff purchased from another bank a note which had been passed to it through several parties from the original holder. The bank was forbidden to deal in any thing, except bills of exchange, gold or silver, or take more than six per cent upon its loans or discounts. It was claimed by defendant that the purchase of the note was *ultra vires*, but the court held that it was not, and that such purchase was but a discount. STORY, J., speaking for the court, says: "But in what manner is the bank to loan? What is it to discount? Has it not a right to take an evidence of debt which arises from the loan? If it is to discount, must there not be some chose in action, or written evidence of a debt, payable at a future time, which is to be the subject of the discount? Nothing can be clearer than that by the language of the commercial world, and the settled practice of banks, a discount by a bank means *ex vi termini*, a deduction or drawback made upon its advances or loans of money upon negotiable paper or other evidence of debt, payable at a future day, which are transferred to the bank." In the case of Smith *v.* Bank, 26 Ohio St. 141, the defense was that the bank (a national bank) purchased the paper of the payees, and that it had no authority to make such purchase. Upon this question, the court says: "It does not state that the purchase was made at a usurious rate of discount, but it avers that under the act of congress to provide a national currency, under which the bank was incorporated, it had no authority to purchase the bill. It seems to be the idea of counsel making the objection that negotiable paper, perfect and available in the hands of the holder, is not the subject of purchase by a national bank at any rate of discount. This view we think entirely erroneous. We see nothing in the act of congress, nor in reason, why a borrower may not obtain the discount, by a bank, of one of the existing notes and bills of others, of which he is the holder, as well as of his own paper, made directly to the bank. It is true that as between natural persons, the purchase of such paper, when made in good faith, and not as a disguise for a loan, is not subject to the usury laws, but it is otherwise as to a bank. In the business of banking, the purchasing and discounting of paper is only 'a mode of loaning money.'"

[3] Pape *v.* Capitol Bank of Topeka, (1878) 20 Kans. 440. BREWER, J., speaking for the court, said: "The power granted is the naked power of discounting, and the term 'discounting' includes purchase as well as loan. 'To discount' signifies the act of buy-

case an action by a bank organized under the laws of New Hampshire, engaged in doing a general banking business, upon a note, the Supreme Court of Missouri sustained the power of the bank under its charter, nothing appearing to the contrary therefrom, to buy outright the notes sued on; at the same time they held that it had no right to purchase them at a greater rate of discount than the rate of interest it might lawfully charge for the loan of that money.[1] In a recent Massachusetts case, an action by a national bank against the indorser of a promissory note, to whose order the note was payable, its right to recover was denied on the ground that it had no title to the note. It was argued that under the statutes of the United States national banks could not buy or sell promissory notes, and that, inasmuch as the bank obtained the note by purchase, it had no right to hold or collect it. KNOWLTON, J., speaking for the Supreme Court of Judicature, declared the law, as they considered it upon these contentions, as follows: "On the question whether a national bank can buy promissory notes in the market as a natural person can, there is a conflict of authority. Its power to do so, if it has any, is conferred by the United States Revised Statutes, section 1536 (13

ing a bill of exchange or promissory note for a less sum than that which, upon its face, is payable. It is, also, undeniably clear that the term 'discount,' when used in a general sense, is equally applicable to either business or accommodation paper, and is appropriately applied, either to loans or sales by way of discount, when a sum is counted off or taken from the face or amount of the paper at the time the money is advanced upon it, whether that sum is taken for interest upon a loan, or as the price agreed upon a sale." See, also, Tracy *v.* Talmage, 18 Barb. 462; Bank *v.* Sherburne, 14 Ill. App. 566.

[1] Salmon Falls Bank *v.* Leyser, (Mo. 1893) 22 S. W. Rep. 504. The court distinguished Bank *v.* Simpson, 1 Mo. 184, in these words: "It is true that it is held by this court in [that case] that the plaintiff, a corporation created under the laws of the state of Illinois, could not under its charter so deal in promissory notes as to become the purchaser thereof. But its charter, the court says, 'restrains the bank generally from dealing or trading except in bills of exchange, gold or silver, or in the sale of goods pledged for money lent or which shall be the proceed of land.' It will be observed that the decision in this case is based altogether upon the restrictions in plaintiff's charter, which was before the court, and incorporated in the bill of exceptions. No such restrictions are shown to have been placed upon plaintiff's powers as a banking institution." That a national bank cannot rescind a contract of purchase of a note on the ground that it had no power to purchase and recover back the money paid for it, see Attleborough Bank *v.* Rogers, (1878) 125 Mass. 339.

U. S. Sts. at Large, 101), which authorizes national banks to discount and negotiate 'promissory notes, drafts, bills of exchange and other evidences of debt,' etc. It has sometimes been held that the right to discount and negotiate notes, etc., goes no further than to authorize the taking of them in return for a loan of money made on the strength of the promises contained in them.[1] By other courts it has been held that the right to 'discount and negotiate' includes the right to buy.[2] If we assume, in favor of the defendant, that national banks are not authorized under the law to go into the market and buy promissory notes from those who are selling them only as a commodity, there are several reasons why this defense cannot prevail. In the first place, if such a purchase is *ultra vires*, it is an ordinary contract; it is not made penal nor expressly forbidden, and the maker or indorser cannot defend on the ground that the bank has obtained no title. The violation of law can be availed of only in proceedings against a national bank in the interest of the public to deprive it of its charter. This has been decided by the Supreme Court of the United States.[3] Secondly, the evidence in this case would well warrant, if not require, a finding by the court that the transaction was a discounting of a note for the defendant within the meaning of the statute. The note was in the hands of the indorser's agent, who consulted the indorser about the rate of interest to be allowed before giving the note to the plaintiff. The plaintiff's money was paid to indorser, less the agent's commission. The transaction would have been no different in substance if the defendant, who held the note as indorser, had carried it to the plaintiff's [plaintiff?] bank and had there made in person the contract which he made through the agent. If he had done that the transaction clearly would have been a negotiation of a loan and a discounting of a promissory note.[4] Thirdly, it

[1] Lazear *v.* National Union Bank, 52 Md. 78, 124; Farmers & Mechanics' Bank *v.* Baldwin, 23 Minn. 198; First National Bank *v.* Pierson, 24 Minn. 140; Niagara County Bank *v.* Baker, 15 Ohio St. 69.

[2] Citing Smith *v.* Exchange Bank, 26 Ohio St. 141; Pape *v.* Capitol Bank of Topeka, 20 Kans. 440. See, also, First National Bank *v.* Harris, 108 Mass. 514, 516; National Pemberton Bank *v.* Porter, 125 Mass. 333; Atlas National Bank *v.* Savery, 127 Mass. 75, 77.

[3] Citing National Bank *v.* Matthews, 98 U. S. 621, and cases cited; National Bank *v.* Whitney, 103 U. S. 99; Merchants' National Bank *v.* Hanson, 33 Minn. 40; Slater Woolen Co. *v* Lamb, 143 Mass. 420.

[4] Citing Lazear v. National Union Bank, 52 Md. 124; Farmers & Mechanics' Bank *v.* Baldwin, 23 Minn.

has been held in this commonwealth, in analogy with the above-cited decisions of the Supreme Court of the United States, but on somewhat different grounds, that, even if a national bank does not get the legal title to a promissory note bought in the market, it may maintain a suit as the holder, and the maker and indorsers cannot be relieved from their contracts to pay the amount promised in the writing."[1]

§ 288. Purchasing stock of corporations.— A national bank, by way of compromising a claim alleged to be due, and for the purpose of averting an apprehended loss on account of such claim, has the right to acquire stock to be again turned into money, but has no right to purchase or acquire such stock either for speculation or investment.[2] Such a bank not being expressly prohibited from becoming a stockholder in another corporation, may take shares in another corporation as collateral security for a loan made by it, or in satisfaction for a loan for which the stock may have been pledged to it as security.[3] The United States Supreme Court has also held that stocks of other corporations may be taken by a national bank with a view to sell them at a profit in adjusting and compromising claims growing out of legitimate banking transactions.[4] The Nebraska Supreme Court, in a recent case involving the power of a bank to purchase the stock of an insurance corporation through its cashier, has, after a review of leading cases bearing upon the subject of corporations purchasing or acquiring stock in others, summed up the law as follows: "It is doubtless true that the bank could legally take the stock of another corporation as security for a debt previously contracted. Possibly it might make a loan on the strength of the stock as security at the time. On this point the authorities are not in harmony, and as it is not material here we do not decide it. An emergency might arise when a bank's board of directors would be justified in taking stock of another corporation in settlement, or adjustment, or compromise of a doubtful claim or debt,

198; First National Bank *v.* Pierson, 24 Minn. 140.

[1] Prescott National Bank *v.* Butler, (1893) 157 Mass. 548, 549, 550; citing Atlas National Bank *v.* Savery, 127 Mass. 75, 77; National Pemberton Bank *v.* Porter, 125 Mass. 333.

[2] First National Bank of Charlotte *v.* National Exchange Bank of Baltimore, 39 Md. 600.

[3] Kennedy *v.* California Savings Bank, (1894) 101 Cal. 495.

[4] First National Bank *v.* National Exchange Bank, 92 U. S. 122.

acting in the honest belief that only by so doing could a serious loss to the bank be averted. None of these reasons, however, existed in the case at bar, or if they did the record before us does not disclose them. The cashier had no authority to bind the bank by buying the insurance company's stock. The board of directors had no authority to authorize him to do so; and if the cashier bought such stock in behalf of the bank the directors had no authority to ratify the purchase and thus bind the bank. * * * We conclude, then, that the powers of a directory of a bank in dealing with and in investing the funds of the stockholders are limited to the purposes for which the bank was incorporated and the purposes necessarily incidental thereto in the successful conduct of its legitimate business."[1] Unless necessary to prevent loss on a debt previously contracted in good faith, a national bank can make no valid loan or discount in security of its own stock.[2] And the placing by one bank of its funds on permanent deposit with another would be a loan within that provision of the National Banking Association Act which prohibits such loans.[3] A national bank, purchasing its own stock to protect itself against loss upon a debt, being bound to sell the stock within six months, may sell on credit and take the purchaser's note, with the stock sold as collateral, to secure it, provided it be done in good faith.[4] Where money has been borrowed of a bank, and the borrower has given as security certificates of his shares of the bank's stock, he would not be entitled to recover, when, on non-payment of this loan, the bank had sold the stock and applied the proceeds to his credit.[5] The opinion of the court, a brief one, rendered by Mr. Justice FIELD, stated the law in such case to be

[1] Bank of Commerce *v.* Hart, (1893) 37 Neb. 197, 205, 206. The cases referred to by the Nebraska court were Mechanics & Workingmen's Mutual Savings Bank & Building Association *v.* Meriden Agency Company, 24 Conn. 159; Franklin Co. *v.* Lewiston Institution for Savings, 68 Me. 43; Nassau Bank *v.* Jones, 95 N. Y. 115. As to the lack of power in one corporation to buy stock of another, see Milbank *v.* New York, L. E. & W. R. R. Co., 64 How. Pr. 20–29; Franklin Bank *v.* Commercial Bank, 36 Ohio St. 355; Central R. R. Co. *v.* Pennsylvania R. R. Co., 31 N. J. Eq. 475; Sumner *v.* Marcy, 3 Woodb. & M. 105; Central R. R. Co. *v.* Collins, 40 Ga. 582; Hazelhurst *v.* Savannah, G. & N. A. R. R. Co., 43 Ga. 13; People *v.* Chicago Gas Trust Co., 130 Ill. 268.

[2] Bank *v.* Lanier, 11 Wall. 369.

[3] Ibid.

[4] Union National Bank *v.* Hunt, (1882) 76 Mo. 439.

[5] National Bank of Xenia *v.* Stewart, 107 U. S. 676.

as follows: "Section 5201 of the Revised Statutes declares that 'no association shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale; or, in default thereof, a receiver may be appointed to close up the business of the association.' While this section, in terms, prohibits a banking association from making a loan upon the security of shares of its own stock, it imposes no penalty either upon the bank or borrower, if a loan upon such security be made. If, therefore, the prohibition can be urged against the validity of the transaction by any one except the government, it can only be done before the contract is executed, while the security is still subsisting in the hands of the bank. It can then, if at all, be invoked to restrain or defeat the enforcement of the security. When the contract has been executed, the security sold, and the proceeds applied to the payment of the debt, the courts will not interfere with the matter. Both bank and borrower are in such case equally the subjects of legal censure, and they will be left by the courts where they have placed themselves. There is another view of this case. The deceased authorized the bank, in a certain contingency, to sell the shares. Supposing it was unlawful for the bank to take those shares as security for a loan, it was not unlawful to authorize the bank to sell them when the contingency occurred. The shares being sold pursuant to the authority, the proceeds would be in the bank as his property. The administrators, indeed, affirm the validity of that sale by suing for the proceeds. As against the deceased, however, the money loaned was an offset to the proceeding. In either view the administrators cannot recover."[1] The Illinois Supreme Court has held, in a late case, that it was no defense in an action to recover a loan from a national bank that the bank had purchased shares of its stock which were pledged for the loan in violation of the law relating to national banking associations, where the purchase of the stock was consummated before the loan was obtained, and the lender had no knowledge of how the stock was acquired by the

[1] Ibid.

bank.[1] A national bank which had received the stock of a savings bank, and still retained it, and had received dividends on the stock, has been held to be estopped from denying its liability for its proportion of the indebtedness of the savings bank contracted during the time of its ownership of stock therein.[2]

§ 289. **Increase of capital stock.** — The comptroller of currency is clothed with power to assent to an increase of the capital stock of a national bank less than that originally voted by its directors but equal to the amount actually subscribed and paid for by the stockholders under the original vote.[3] The capital of a national banking association having become impaired by reason of past due and suspended claims, should its stockholders, to avoid a threatened assessment by the comptroller of currency upon the stock to make good the deficiency, lawfully reduce the capital stock in an amount equal to the deficiency, a stockholder cannot, in case the suspended claims be subsequently realized upon and carried into the account as assets, compel the bank to distribute a share of the money so realized in proportion to the amount of stock surrendered by him.[4] The validity of the proceedings for an increase of the stock of a national bank cannot be questioned by a stockholder who, with the knowledge of its insolvent condition and of all material facts, may have subscribed for increased stock to same amount as his original stock, and amount of proposed increase was afterwards reduced, in an action to annul his subscription and payment.[5]

§ 290. **Loans.**— Where a state bank has been organized into a national bank under the national law, and the national bank had taken from the state bank, among the discounted notes, one for a larger amount than the national bank was authorized to loan to a single borrower, the Supreme Court of Ohio held that such note or any note subsequently given in renewal of it was not to be regarded within the meaning of the national act as given for

[1] Chemical Nat. Bank of Chicago *v.* City Bank of Portage, (Ill. 1895) 40 N. E. Rep. 328.

[2] Kennedy *v.* California Savings Bank, (1894) 101 Cal. 495.

[3] Aspinwall *v.* Butler, 133 U. S. 595.

[4] McCann *v.* First National Bank, (1887) 112 Ind. 354.

[5] Delano *v.* Butler, 118 U. S. 634; Pacific National Bank *v.* Eaton, 141 U. S. 227; Thayer *v.* Butler, 141 U. S. 234; Butler *v.* Eaton, 141 U. S. 240.

money borrowed of the national bank.[1] In an action by a national bank for money loaned, the defendant cannot set up as a bar that the loans exceeded in amount one-tenth part of the capital stock of the bank.[2] The security taken by a national bank for loans will not be invalidated by the fact that the loans may be in violation of the act of congress which prohibits the lending of more than one-tenth of its paid-up capital to one person.[3] Should a bank accept a renewal note from the agent of the principal for an amount greater than is actually due, with fraudulent intent, it will vitiate the whole, and the bank cannot recover upon it. If it be a mistake, the bank may recover the amount actually due.[4] Should the maker of a note conspire with the president or other officer of a bank to defraud it, and on the faith of the note the bank parts with its money, the bank can recover it from the

[1] Allen *v.* First National Bank, Xenia, (1872) 23 Ohio St. 97.

[2] Gold Mining Co. *v.* National Bank, (1877) 96 U. S. 640. Mr. Justice HUNT, speaking for the court, said: "After obtaining and holding to its own use the money, can the mining company be allowed to interpose the plea that the bank had no right to loan the money? In Harris *v.* Runnels, 12 How. 79, where the defendant sued upon a note set up the illegality of its consideration, it was held that the whole statute then in question must be examined to discover whether it intended to prevent courts of justice from enforcing contracts in relation to the act prohibited; and that when a statute prohibited an act or annexes a penalty for its commission, it does not follow that the unlawfulness of the act was meant to avoid a contract made in contravention of it. A statute provided that slaves should not be brought into the state without a previous certificate signed by two freeholders. Slaves were brought in without such certificate and sold, and the purchaser was held liable for the purchase money. Mr. Justice WAYNE said that the rule was allowed not for the benefit of either party to the illegal contract, but altogether upon grounds of public policy. In O'Hare *v.* The Second National Bank of Titusville, 77 Pa. St. 96, the question was made upon the statute we are considering, and it was objected that the bank could not recover the amount of the loan in excess of the proportion specified. The court held that the section of the statute referred to was intended as a rule for the government of the bank, and that the loan was not void. See, also, Pangborn *v.* Westlake, 36 Iowa, 546; Vining et al. *v.* Bricker, 14 Ohio St. 331. We do not think that public policy requires, or that congress intended, that an excess of loans beyond the proportion specified, should enable the borrower to avoid the payment of the money actually received by him. This would be to injure the interest of creditors, stockholders, and all who have an interest in the safety and prosperity of the bank." See, also, Farmers' Bank *v.* Burchard, 33 Vt. 346.

[3] Stephens *v.* Bank, 88 Pa. St. 157.

[4] Bates *v.* Short, 3 Pennypacker (Pa), 495.

maker.[1] Where money is paid on forged paper by discounting or cashing it by a bank, it can be recovered back provided the bank has not materially contributed to the mistake itself, and has given a sufficiently early notice of the mistake to the other party after discovering it.[2] In a Vermont case, it appeared that the defendant signed a writing addressed to the person who was the cashier of the bank by name only, saying: "I wish you to discount a note," etc., and guaranteeing its goodness and payment. On the credit of this guaranty the bank discounted the note. The Supreme Court held that an action on the guaranty lay in the name of the bank counting upon a promise to the bank.[3]

§ 291. Dividends on bank shares.— The board of directors of a bank have discretionary power to declare dividends and the amount of same, and a very strong case must be presented to induce a court to interfere.[4] Where the articles of association of a bank provided that there should be a semi-annual dividend, and vested all the powers and privileges of the members of the association in a board of directors, the Court of Chancery of New York held that it was competent for the board to determine in any year not to declare a dividend, and that a shareholder could not maintain a bill to restrain the collection of the securities he had given the association in consideration of his shares, because they had determined to forego a dividend in that year.[5] A dividend declared and paid, and credited on a call for payment of the stock subscriptions by a banking association, having nearly a third of its capital locked up in a suspended and uncertain debt, though it was believed there would be no ultimate loss, has been held to be illegal as against the creditors of the association.[6] It has been held that a dividend declared by a bank could not be made payable in bills of county banks, solvent, but quoted below par in the city of New York.[7] A stockholder in a bank is not entitled to interest from the bank, either on ordinary dividends declared

[1] Tagg *v.* Tennessee National Bank, (1872) 9 Heisk. (Tenn.) 479.

[2] Third National Bank *v.* Allen, (1875) 59 Mo. 310.

[3] Woodstock Bank *v.* Downer, 27 Vt. 482.

[4] State *v.* Bank of Louisiana, 6 La. 746.

[5] Ely *v.* Sprague, (1840) Clarke, 351.

[6] Sagory *v.* Dubois, (1846) 3 Sandf. Ch. 466.

[7] Ehle *v.* Chittenango Bank, (1862) 24 N. Y. 548.

on his shares or on money due him from a reduction by the bank of its capital stock, for a period during which the bank may be prevented from paying him the same by attachments of his stock in suits pending in court between him and other parties, although the money thus belonging to him may be during such time mingled by the bank with its general assets, the bank being ready and willing to pay over the same but for the attachments, and having on hand all the time a balance of money sufficient for the purpose.[1] A national bank in Texas having declared a dividend, providing in its resolution that the cashier should not pay such dividend to the stockholders until the respective indebtedness of each stockholder should first be paid out of his portion of such dividend, and one of its stockholders being indebted as guarantor and otherwise of certain notes held by the bank, his dividend was applied to the payment of the same. He brought his action against the bank for his dividend. The court specially held that the bank could not set off against such dividend the amount of notes guaranteed by such stockholder, where the original makers had not been exhausted, and no effort had been made by the

[1] Mustard *v.* Union Nat. Bank, (Me. 1893) 29 Atl. Rep. 977. PETERS, Ch. J., said: "The [stockholder] contends that the bank, as to these funds, did not stand in the condition of an ordinary debtor, but became a stockholder or trustee for the owner of them; and that, having received the profits and benefits of the funds, it is liable for interest on the same. We do not feel satisfied to apply the rule invoked by the plaintiff. There was no promise of interest in any way, and no disposition to withhold the funds, except for self-protection. There was more money at all times on hand and unemployed than the sum due the plaintiff in readiness for appropriation on the debt. It would be an unheard of claim to charge a bank with a liability to pay interest on deposits or declared dividends when there is no promise to do so nor any fault on the part of the bank. And the funds in question were in no more favorable condition for the owner of them than ordinary deposits or dividends. All uncalled-for deposits and dividends held by any bank, or at any rate the bulk of them, become mingled in the moneys and investments of the bank, and that is one source of its legitimate business profits. * * * The cases in Massachusetts, where this same question has repeatedly arisen, are adverse to the plaintiff's claim. Oriental Bank *v.* Tremont Ins. Co., 4 Met. 1; Huntress *v.* Burbank, 111 Mass. 213; Smith *v.* Flanders, 129 Mass. 322. And we do not perceive that our own cases favor the claim. In Norris *v.* Hall, 18 Me. 332, the *debt* in the trustees' hands was on its face running upon interest. Blodgett *v.* Gardiner, 45 Me. 542, was a similar case. And in Abbott *v.* Stinchfield, 71 Me. 213, the trustee, an attorney at law, had collected funds for his client, and deposited them in a savings bank upon interest for his client's benefit."

bank to collect the notes from them, and they were not shown to be insolvent or beyond the jurisdiction of the court; and in case the maker of a note was insolvent and in the penitentiary or non-resident, protest and notice or suit at the first term were not necessary to hold the indorser, but the debts became an original liability of the indorser.[1]

§ 292. Lien of banks on moneys and securities of its customers.— A bank has a lien on all moneys and securities of a customer coming into its possession in the regular course of business for any balance due it on general account.[2] A banker's lien does not extend to all securities happening to be in his hands for any purpose.[3] A bank has no general lien on securities deposited with it by a customer as collateral for a particular debt.[4] The lien of a bank resting upon the presumption of credit extended on faith of securities in possession or expectancy, will not arise in reference to securities in possession of the bank under circumstances, or where there is a particular mode of dealing, inconsistent with such lien.[5] By the law merchant a banker has a general lien on all securities deposited with him by a customer for his general

[1] First Nat. Bank of Texarkana *v.* De Morse, (Tex. 1894) 26 S. W. Rep. 417. The Texas Civil Court of Appeals, upon the general principles of law involved in the case, said: "A bank, in its dealings with its customers, has a right to pay a debt due to it out of money in the possession of such bank to the general credit of such customers, whether derived from dividends or any other source. Traders' Nat. Bank of San Antonio *v.* Cresson, 75 Tex. 298; s. c., 12 S. W. Rep. 819, and authorities there cited; Nashville Trust Co. *v.* Fourth Nat. Bank, (Tenn.) 18 S. W. Rep. 822; Hagar *v.* Bank, 63 Me. 509; Morse on Banks, 34; Newmark on Bank Dep. § 22; Id. § 117. There is a general rule, subject to some exceptions, that a bank has a lien on all moneys and funds of a depositor in its possession to secure any balance due the bank by such depositor. Bank *v.* Weems, 69 Tex. 489; s. c., 6 S. W. Rep. 802; 1 Morse on Banks, § 324; Id. § 327; Newmark on Bank Dep. §§ 22, 117; Bank *v.* Hughes, 17 Wend. 94; Fegley *v.* McDonald, 89 Pa. St. 128; Bank *v.* Henninger, 105 Pa. St. 496; Bank *v.* Peck, 127 Mass. 300. Mr. Morse, in his excellent work on Banks and Banking (Vol. 2, § 699e), says: 'But the bank has a lien upon dividends; or, more properly, it may set off dividends accruing upon the shares of a stockholder against indebtedness of a stockholder to the bank, for the dividend is a simple debt owing from the corporation to the stockholder. Hagar *v.* Bank, 63 Me. 509.'"

[2] In re Tallassee Manufacturing Co., 64 Ala. 567.

[3] Petrie *v.* Myers, (Sup. Ct. N. Y. Spl. Term, 1877) 54 How. Pr. 513.

[4] Grant *v.* Taylor, 35 N. Y. Super. Ct. 338.

[5] Reynes *v.* Dumont, 130 U. S. 354.

balance, unless there be an express contract, or circumstances that show an implied contract inconsistent with such lien, and of this courts will take judicial notice.[1] The doctrine of bankers' liens is not the law of Pennsylvania.[2] A banker's lien does not extend to trust funds which his debtor, acting as an agent, has deposited in the name of a third person.[3] A banker has, upon a security pledged for a specific sum, a lien for that amount only, and he cannot, by reason of a banker's general lien on securities in his hands, extend it to cover other advances, unless by special agreement.[4] If there have been for a long time mutual dealings and an account current between two banks, in which they have mutually credited each other with proceeds of all paper remitted for collection when received, and charged all costs of protests, postage, etc., and transmitted their respective accounts regularly from one to the other, and settled them as the accounts of the respective banks; and upon the face of the paper transmitted it has always appeared to be the property of the banks respectively remitted on their own account, and balances have been generally allowed to remain until reduced by proceeds of such bills so transmitted from one to the other, in usual course of business, either of the banks would have a lien upon paper thus transmitted for a general balance of account, no matter who might be the real owner of the paper.[5] Where a bank paid an insolvent depositor's note, which it had indorsed, and which had been duly protested for nonpayment, and was afterwards garnished for deposits in its hands belonging to such depositor, the Texas Civil Court of Appeals held that the bank had the right to retain out of the deposit due the maker sufficient to secure it against loss, and was responsible only for the balance remaining in its hands after the payment by it of the depositor's note for which it had obligated itself by its indorsement.[6] It was held in a case in a federal court that the United States Revised Statutes, section 5242, which invalidates

[1] Wyman *v.* Colorado National Bank, (1879) 5 Colo. 30; citing Brandao *v.* Barnett, 3 Man., G. & S. 530. As to banker's lien upon securities belonging to his customers for balances due from them, see Cornwell *v.* Kinney, 1 Handy (Ohio), 496.

[2] Spring & Axle Co.'s Appeal, 111 Pa. St. 291.

[3] Falkland *v.* St. Nicholas National Bank of New York, (1881) 84 N. Y. 145.

[4] Duncan *v.* Brennan, (1881) 83 N. Y 487.

[5] Rathbone *v.* Sanders, (1857) 9 Ind. 217.

[6] Rosenberg *v.* First Nat. Bank of Texarkana, (Tex. Civ. App. 1894) 27 S. W. Rep. 897; citing Burrow *v.* Zapp, 69 Tex. 474; s. c., 6 S. W. Rep. 783; Traders' Nat. Bank of San Antonio *v.* Cresson, 75 Tex. 298; s. c., 12 S. W. Rep. 819.

all transfers of the notes, bonds or bills of exchange of a national bank, after the commission of an act of insolvency, with a view to the preference of one creditor over another, does not prohibit a bank which has in good faith accepted the draft of a national bank the day before the latter's insolvency, and afterwards paid the same, from applying the proceeds of collections made by it on paper in its hands belonging to the insolvent bank to the payment of the draft since its lien on such collections runs from the date of acceptance.[1] The United States Circuit Court for the southern district of New York has held that the same statute did not prevent the retention of a balance standing to the credit of an insolvent national bank with a correspondent bank on the day of its failure, which balance had been pledged for the purpose of securing loans made to the insolvent bank by the correspondent bank.[2]

§ 293. Lien of a bank on shares of stockholders for their debts to the bank.— The Delaware court has sustained the validity of a by-law made by the directors of a bank that no stockholder should have the right to transfer his stock while indebted to the bank, and such by-law held to give the bank a lien on the stock for the debts of the holder thereof.[3] Where a bank issues stock transferable on its face there is no lien upon it

[1] In re Armstrong, (1890) 41 Fed. Rep. 381.

[2] Bell *v.* Hanover National Bank, (1893) 57 Fed. Rep. 821; citing Bank *v.* Colby, 21 Wall. 613. Lacombe, Circuit Judge, said further: "Neither the subsequent insolvency of the bank nor the appointment of the receiver destroyed the lien of defendant, nor its right to dispose of the pledge to satisfy the debt thus secured." Scott *v.* Armstrong, 146 U. S. 499; s. c., 13 Sup. Ct. Rep. 148

[3] McDowell *v.* Bank of W. & B., 1 Harr. (Del.) 27. As to lien on stock for debt of the stockholder, see Bank of Holly Springs *v.* Pinson, 58 Miss. 421; Conant *v.* Seneca County Bank, 1 Ohio St. 298. As to whether a by-law of a bank can create a general lien on the shares of a stockholder for any debt due the bank from the stockholder, so as to affect the creditors of the stockholder, see Nesmith *v.* Washington Bank, (1828) 6 Pick. (Mass.) 324. As to a bank having a lien upon the stock of a stockholder who may have died leaving notes due and to become due, payable to the bank, for the amount of the indebtedness, see Downer *v.* Zanesville Bank, (1833) Wright (Ohio), 477. As to the lien, given by its charter, to a bank on the stock held by the debtor, having a priority over a claim of the United States, see Brent *v.* Bank of Washington, 10 Pet. 596. As to the effect of a charter or by-laws of a bank prohibiting the transfer of shares of its stock until all the debts of the stock-

for any debt the stockholders owe the bank.[1] A bank may hold a cash dividend as pledged for the debt of its shareholders to the bank.[2] A bank has been held not to have a specific lien upon the dividends of one of its stockholders in consequence of its right to prevent the transfer of his stock until his debt to the bank should be paid.[3] A bank has no lien on the stock of one indebted to it in preference to other creditors. A *lis pendens* would give preference to such creditors.[4] A bank may waive the privilege given it by its charter of preventing the transfer of its stock by any stockholder whose debt to the bank is actually due, until payment of the debt.[5] The provision in such articles of incorporation that "no shares shall be transferable unless the shareholder previously discharge all debts due him by the association," has been held to include not only matured debts but also liabilities unmatured.[6] This lien attaches when the bank is asked to transfer the legal title. Where one becomes the owner of stock subject to this provision in the articles of which he has knowledge, and has omitted to give the bank notice of his ownership, thus enabling it to have credit on the faith of the assignor of the stock being a stockholder, he will have no superior equity to that of the bank.[7] A provision in the articles of association of a bank that no shareholder should transfer his shares, or receive a dividend thereon, who should owe the bank a debt then due, unless by consent, etc.; and another giving authority whenever such a debt should be past due to sell the stock and apply the proceeds to pay the debt, have been held to create a lien upon the stock in favor of the bank for the debts of the stockholder. The court also held that the debts of a partnership of which the stockholder was a member, were his debts within the rule.[8] In case a bank release for a time its lien given it by its charter, upon the stock of a shareholder for debts due by the latter to the bank, and

holder to the bank are paid, see Union Bank *v.* Laird, 2 Wheat. 390. That a bank may waive its right, under the last provision, see National Bank *v.* Watsontown Bank, 105 U. S. 217.

[1] Fitzhugh *v.* Bank of Shepherdsville, (1825) 3 Mon. (Ky.) 128.

[2] Hagar *v.* Union National Bank, 63 Me. 509.

[3] Brent *v.* Bank of Washington, 2 Cranch Cir. Ct. 517.

[4] Dana *v.* Brown, (1829) 1 J. J. Marsh. (Ky.) 304.

[5] Hodges *v.* Planters' Bank, 7 G. & J. (Md.) 306.

[6] Leggett *v.* Bank of Sing Sing, (1862) 24 N. Y. 283.

[7] Ibid.

[8] Arnold *v.* Suffolk Bank, (1857) 27 Barb. 424.

during that interval of time the stock be pledged by its owner for debt to a third party, the rights of the bank will be subordinate to the rights of the pledgee until his debt is paid or the stock released by the pledger.[1] The lien that a bank has upon the stock of its debtor will not be affected by the fact that the debt is barred by the Statute of Limitations.[2]

§ 294. Interest reserved by banks.— Legal interest, on sums discounted by banks, is that established by their chartesr.[3] They can, in no case, take more interest than that fixed by their charters.[4] Banking laws limit the right of a bank to take interest. Reserving or taking interest in excess of that limit, makes the transaction usurious, and the general usury law applies to it.[5] The taking of interest in advance upon loans made by a bank is within the well-established rules of banking. But after a note given to it has become payable, and in no manner taken up and renewed, a bank cannot lawfully take upon it a rate of interest exceeding the rate allowed by law.[6] Where a bank discounts a note payable directly to itself, it will not be usury to take the interest in advance for the time the note has to run, this being the usage of banks.[7] Discount means, *ex vi termini*, a deduction or drawback made upon advances or loans of money upon negotiable paper or other evidences of debt payable at a future time, which are transferred to a bank.[8] The rate of interest on loans

[1] Bank of America *v.* McNeil, (1877) 10 Bush (Ky.), 56.

[2] Farmers' Bank of Maryland *v.* Iglehart, 6 Gill (Md.), 55. That a national bank cannot create or hold, by its articles of association or by-laws, a lien on its stock to secure the indebtedness of stockholders to it, see Second National Bank of Louisville *v.* National State Bank of New Jersey, (1874) 10 Bush (Ky.), 375.

[3] Bank of Louisiana *v.* Sterling, 2 La. 62; Clinton County *v.* Kernan, 10 Rob. (La.) 174.

[4] Bank of Louisiana *v.* Stansbury, 8 La. 261.

[5] Rock River Bank *v.* Sherwood, 10 Wis. 230; Durkee *v.* City Bank, 13 Wis. 216; Brower *v.* Haight, 18 Wis. 102.

[6] Ticonic Bank *v.* Johnson, 31 Me. 414.

[7] Union Bank *v.* Corcoran, 5 Cranch Cir. Ct. 513.

[8] First National Bank *v.* Sherburne, 14 Bradw. (Ill.) 566. As to what is a discount, see Fleckner *v.* Bank, 8 Wheat. 338; Bank *v.* Johnson, 104 U. S. 271; Tracy *v.* Talmage, 18 Barb. 456; Niagara County Bank *v.* Baker, 15 Ohio St. 68; Pape *v.* Bank, 20 Kans. 440; Bank *v.* Sherburne, 14 Ill. App. 566; First Nat. Bank *v.* National Exchange Bank, 92 U. S. 122. As to interest, see Guthrie *v.* Reid, 107 Pa. St. 251; Barnet *v.* Bank, 98 U. S. 555; Nash *v.* Bank, 68 N. Y. 396; Bank *v.* Carpenter, 52 N. J. Law, 165; s. c., 19 Atl. Rep. 181; Bank *v.* Stauffer, 1 Fed. Rep. 187; Bank *v.* Childs, 133 Mass.

or discounts being limited in the charter of a bank, it cannot stipulate for a higher rate in consideration of its forbearance to sue.[1] It is not usurious in a bank to receive interest in advance on notes discounted by it.[2] Requiring and taking exchange in New York by a bank upon a note intended to be, and actually paid, in Wisconsin, in addition to ten per cent interest, has been held to be usury.[3] The taking of exchange, in addition to ten per cent in discounting a draft, was, however, held to be lawful, if not intended to evade the usury laws.[4] A national bank may take the rate of interest allowed to natural persons generally by the law of the state where it is located, and a higher rate where state banks of issue can take it.[5] National banks are subject to the penalty against usury imposed by the federal law and not to that imposed by state law.[6] Usurious interest paid a national bank on renewing a series of notes cannot, in an action by the bank on the last of the notes, be pleaded as a satisfaction of the debt.[7] The rule in Vermont is to treat the receiving by a bank of interest upon loans or discounts exceeding the rate prescribed by the laws of that state, as having the effect only to render the contracts void as to the excess of interest taken.[8] Interest alleged to be usurious, having been paid to a national bank, the usurious interest cannot afterwards be pleaded as a payment in an action

248; Alves *v.* Bank, 3 Browne Nat. Bank Cas. 452; c. f., Smith *v.* Bank, 26 Ohio St. 141; Bank *v.* Littell, 47 N. J. Law, 233. In N. Y. State Loan & Trust Co. *v.* Helmer, 77 N. Y. 64, 68, buying notes or advancing money on notes is distinguished from "discounting." Lester *v.* Bank of Mobile, 7 Ala. 490; Branch Bank at Mobile *v.* Strother, 15 Ala. 51; Kitchen *v.* Branch Bank at Mobile, 14 Ala. 233; Branch Bank at Montgomery *v.* Harrison, 1 Ala. 9. As to interest and usury on the part of a bank, and the effect of penalties, see Atlantic State Bank of Brooklyn *v.* Savery, (1880) 82 N. Y. 291; Nash *v.* White's Bank of Buffalo, (1877) 68 N. Y. 396.

[1] Exchange Co. *v.* Boyce, 3 Rob. (La.) 307. As to the reservation of interest in the way of discounts exceeding the rate of interest allowed a bank being a violation of its charter, see State *v.* Boatmen's Savings Institution, (1871) 48 Mo. 189.

[2] Duncan *v.* Maryland Savings Institution, 10 G. & J. (Md.) 299.

[3] Durkee *v.* City Bank, 13 Wis. 216.

[4] Central Bank *v.* St. John, 17 Wis. 157.

[5] Tiffany *v.* National Bank of Missouri, 18 Wall. 409. See. also, National Bank *v.* Johnson, 104 U. S. 271.

[6] Barker *v.* Rochester National Bank, 59 N. H. 310.

[7] Driesbach *v.* National Bank, 104 U. S. 52; Barnet *v.* National Bank, 98 U. S. 555. See, also, as to the remedy under the national law being exclusive, Stephens *v.* Monongahela Bank, 111 U. S. 197.

[8] Bank of Middlebury *v.* Bingham, 33 Vt. 621.

by the assignee of the bank.[1] The demand and receipt by a national bank of usurious interest from indorsers upon notes discounted by it, the payments of which notes may be guaranteed to the bank by a third party in a written guaranty, will not avoid the contract of guaranty between such third party and the bank.[2] In Pennsylvania a national bank cannot take more than six per cent upon the discount of a note, without showing that the state banks of issue are allowed to do so.[3] Where a charter of a bank provided "that said corporation shall not take more than at the rate of six per centum on its loans or discounts," a note on which in discounting the bank had reserved a rate of interest greater than six per cent, was held to be void for want of power in the bank to make such a contract.[4] National banks are subject only to the penalties prescribed by the United States Banking Association Act for taking usury.[5] Where usurious interest has been previously received by a national bank in the course of renewals of a series of notes, terminating in a note on which an action may be brought, the usurious interest cannot be pleaded by way of set-off or payment. The only remedy open to the party aggrieved is that prescribed by the act of congress — a separate action for double the interest paid by him.[6] A national bank located in Kansas, charging and receiving interest at the rate of eighteen per cent per annum, was held liable under the National Banking Act to pay back twice the amount of interest thus received.[7] The person paying such interest having

[1] Childs *v.* Alexander, 22 S. C. 185. That the laws of the state imposing penalties for taking usury do not apply to national banks, see Central Bank *v.* Pratt, (1874) 115 Mass. 539; Davis *v.* Randall, (1874) 115 Mass. 547. As to the provisions of the National Banking Act with reference to forfeiture for taking usurious interest, see Central Bank *v.* Pratt, (1874) 115 Mass. 539; Davis *v.* Randall, (1874) 115 Mass. 547. As to the power to deduct interest from the amount of the loan and in advance, see Maine Bank *v.* Butts, (1812) 9 Mass. 49; Agricultural Bank *v.* Bissell, (1832) 12 Pick. (Mass.) 586.

[2] Lazear *v.* National Union Bank of Maryland, at Baltimore, (1879) 52 Md. 78.

[3] Bank *v.* Gruber, 91 Pa. St. 377; Bank *v.* Bletz, 2 Pennypacker (Pa.), 170.

[4] Bank of Chillicothe *v.* Swayne, (1838) 8 Ohio, 257.

[5] Merchants & Farmers' National Bank of Charlotte *v.* Myers, 74 N. C. 514. As to a state court not having jurisdiction of a bill to recover usury paid to a national bank, see Hambright *v.* Cleveland National Bank, (1891) 3 Lea (Tenn.), 40; Farmers & Mechanics' Bank *v.* Dearing, 91 U. S. 29.

[6] Oldham *v.* Bank, 85 N. C. 240.

[7] Crocker *v.* National Bank of Chetopa, (1876) 4 Dill. 358.

gone into bankruptcy, the court held that the right of action for recovery of the penalty imposed by the act of congress passed to his assignee in bankruptcy.[1] The amount of the recovery was twice the full amount of interest paid, and was not limited to twice the excess of interest paid over the legal rate.[2] The Indiana Supreme Court has held that a note given to a national bank was not void, either as to the maker or surety, from the fact that the bank knowingly reserved and received usurious interest.[3] They also held that where an illegal rate of interest had been paid in advance, in an action on the debt by a national bank, the illegal interest could not be recouped.[4] In Indiana a national bank is entitled to charge and receive interest at the rate of ten per cent, to which may be added current rate of exchange for sight drafts, when *bona fide* made. In an action by a national bank on an evidence of debt, payable to it or its use, where it has unlawfully received illegal interest, the entire interest that the debt carries with it, or which has been agreed to be paid, will be forfeited, and no recovery can be had for interest unpaid.[6] The one who has paid the illegal interest may recover back double the illegal amount of interest he may have paid in an action for debt.[7] Where the assignment of error is the admission of certain evidence touching the consideration of a note discounted by a bank, the question whether the bank exceeded its powers by taking more than legal interest cannot be raised on error.[8] The Supreme Court of Colorado, in a very recent case, have accepted the con-

[1] Ibid.

[2] Ibid.

[3] Wiley *v.* Starbuck, (1873) 44 Ind. 298.

[4] Ibid.

[5] Ibid.

[6] Ibid.

[7] Ibid. In La Dow *v.* First Nat. Bank of New London, 51 Ohio St. 234, it was held that a national bank located in that state might, since the repeal of the statutes fixing the rate of interest for banks of issue, reserve and charge interest at the rate of eight per cent. Shunk *v.* Bank, 22 Ohio St. 508, distinguished. As to interest and usury taken by banks, see Commercial Bank of Manchester *v.* Nolan, 7 How. (Miss.) 508; Grand Gulf *v.* Archer, 8 Smedes & Marsh. (Miss.) 151; Chambliss *v.* Robertson, 1 Cushman (Miss.), 302; Planters' Bank *v.* Snodgrass, 4 How. (Miss.) 573; Forniquet *v.* West Feliciana R. R. Co., 6 How. (Miss.) 116; Killingsworth *v.* Commercial Bank of Rodney, 9 Smedes & Marsh. (Miss.) 628; Knox *v.* Bank of United States, 4 Cushman (Miss.), 655; State *v.* Commercial Bank of Manchester, 4 George (Miss.). 474; Bailey *v.* Murphy, Walker (Mich.). 424; Farmers & Traders' Bank *v.* Harrison, 57 Mo. 503; Lyon *v.* State Bank, 1 Stew. (Ala.) 442.

[8] Murrah *v.* Branch Bank at Decatur, 20 Ala. 392.

clusions of the courts of certain states that national banks may charge as high a rate of interest as is allowed to either individuals or banks of issue in the various states of their organization; that in all states where there is a statute fixing a rate of interest, the only limitation upon this right must be found in the statute itself. The restriction contained in the National Banking Act, which forbade national banks to charge more than seven per cent interest only, became operative in the absence of state legislation on the subject. Wherever the state legislature has acted, the general grant of power to banks to charge whatever rate might be reserved by either citizens or banks of issue became operative. Under this construction thay said: "Banks in Colorado are placed on precisely the same footing as individuals. The legislative act on the subject fixed a rate, to wit, eight per cent, and further provided another rate of interest, which is determined by the agreement of the parties. That the legislature has failed to say the rate shall not exceed twelve per cent per annum, or five per cent per month, does not destroy the legal effect of the enactment, nor restrict its operations to other banks or citizens generally, nor make the case one where no rate of interest is named, whereby the federal limitation becomes operative. In common with these other courts, which have reached a similar conclusion, we hold that national banks in Colorado stand on the same footing in the matter of interest that other banks and individuals occupy."[1]

[1] Rockwell *v.* Farmers' Nat. Bank of Longmont, (Colo. 1894) 36 Pac. Rep. 905. The argument and reasoning of the court, speaking through Bissell, P. J., so fully explains the leading decisions of the courts, federal and state, and is so exhaustive of the whole subject that it is deemed worthy of a place in these notes. It was said: "In reality the only question involved is as to the right of a national bank in Colorado to reserve and receive, whether by way of loan or discount, a greater rate of interest than seven per cent. In no event could the sums paid by way of interest, even though illegal, be applied to the reduction of the principal sum due on the note. Though some states, in the litigations arising on the National Banking Act, adjudged this admissible where a counterclaim was a proper method of defense, the question was settled adversely to the claim by the Supreme Court of the United States. That court decided that, in suits upon notes where illegal interest was reserved, a defense based upon the reservation of the illegal interest would simply limit the recovery to the principal sum due. Barnet *v.* Bank, 98 U. S. 555; Driesbach *v.* Bank, 104 U. S. 52. The sole remaining inquiry concerns the recovery of the thirty-one dollars included in the judgment by way of interest, according to the tenor of the note. The statutes in Colorado concerning interest have been in force ever since it was a state. The act has always provided a specific rate

The United States Circuit Court of Appeals for the third circuit has held that the purchase of accepted drafts by a national bank from the holder without his indorsement at a greater reduction than lawful interest on their face value, was a discounting of those drafts, within the meaning of Revised Statutes United

of interest, which is now eight per cent, but the act regulating the matter has likewise contained a section permitting parties to stipulate for any rate of interest and authorizing the recovery of the stipulated interest. The National Banking Act, as amended in 1864 (§§ 5197, 5198, U. S. Stats.), in general provides that such banking associations may reserve and receive any rate of interest allowed by the law of the state wherein the bank is organized. There was some contrariety of opinion among the state courts as to the extent of the power conferred by these two sections and concerning the proper construction of the clause granting the banks the right to charge interest in those states where one rate was prescribed for banks of issue and another for persons generally. This matter has likewise been settled by the Supreme Court of the United States, which has held that the banks may charge either rate at their pleasure, selecting, if they choose, the maximum. Tiffany *v.* Bank, 18 Wall. 409. None of these Supreme Court decisions, however, touch the matter in issue, which is, are national banks in states having a statute upon the subject of interest which fixes a rate, but likewise contains a provision authorizing parties to stipulate as they may choose respecting this matter, authorized to contract like other citizens living within the sovereignty? This question has not been settled. The statute respecting national banks has been in force for upwards of thirty years, and considerable litigation has arisen on this particular question. The suits have taken various forms, and the query has been presented by way of defense to prevent the recovery of the stipulated interest, and likewise in actions brought to recover the penalty of twice the interest where the rate has been manifestly illegal. Nevertheless, it remains true that the question as here presented has never reached the Supreme Court of the United States. The case relied on by the appellant, and which at first blush would seem to sustain his contention, is Bank *v.* Johnson, 104 U. S. 271. This case went up on writ of error to the Court of Appeals of the state of New York, and the federal tribunal took jurisdiction because of the question involved. In support of our position that this case is not decisive of the present controversy, and in reality does not touch the principles under discussion, it is needful to state what that case is, the point at issue, and other questions determined. This was a penal action against the bank, brought originally by Johnson in the Supreme Court of New York to recover twice the interest alleged to have been reserved and received by the corporation in the business done by the parties. Johnson insisted that the bank was subject to the penalties and liable to the provisions of the statute respecting usury and interest in the state of New York, which, in general, provided that all usurious loans should be absolutely void and the lender could recover neither principal nor interest. On the other hand, the bank insisted that, according to the terms of the transaction, it was one entirely analogous to the discount of paper by the bank where the note was

States, section 5197, which prohibits national banks from taking interest on any loan or discount made by them at a greater rate than is allowed by the laws of the state where they are situated; also, that the acceptor of drafts so purchased might defend against the recovery of interest thereon by the bank, under

made by A. to the order of B., who indorsed and sold it to the bank. It must be remembered that these two propositions are dependent upon two considerations. That respecting usury is dependent upon positive statute; that respecting the law of discount is a judicial declaration of the law, and is not a creature of legislative enactment. For more than half a century it has been the law of New York that, in the matter of discount, banks were not amenable to the usury statute. It may seem like a judicial evasion of the law, but in that mercantile community it has never been changed, the courts holding in a case of that description there are two contracts resulting from the facts — the first, an executed contract concluded by the indorsement and delivery of the paper, whereby the title passes to the holder; the other, an executory agreement between the indorser and the indorsee, operative on the default of the maker. Of course the two contracts are somewhat different in their limitations, since in the one case the bank recovers from the maker the amount of the note and the interest, and, in the other, the sum loaned, which is treated as the consideration of the executory agreement. Both these questions were resolved by the Court of Appeals in the negative, and their conclusion was affirmed by the Supreme Court. It was decided that state statutes respecting usury were not applicable to the national banks, excepting in so far as they might be examined to ascertain what rate of interest the national banks were entitled to reserve. The scope of the Banking Act and the right of the general government to establish the system, delegate the power granted and impose restrictions on the banks organized under it were fully considered in the case of Bank *v.* Dearing, 91 U. S. 29. It was there decided that these banks were part of the instruments adopted to aid in the administration of the government in one of its most important departments. The corollary was that the states could exercise no control over them, nor in any wise affect their operations, except in so far as power might be granted by the act itself. This principle compelled the court to conclude that the usury laws in New York, save in the particular referred to, neither controlled nor in any wise affected Johnson's right of recovery. It was equally plain and so held by the court that the law declared in New York respecting the discount of paper had neither force nor application to the question at issue. In the first place it was not a matter of positive statute respecting the subject of interest, but was simply a judicial determination by the courts of New York that the discount of paper under the circumstances suggested did not come within the purview of the usury statute. Since the statutes of the state could only be resorted to for the purpose of ascertaining what rate of interest national banks might charge, manifestly the decisions of the appellate courts of that state respecting the matter of discounts were of no consequence, and afforded no possible solution of the query. There was another equally cogent reason, and one possibly more

Revised Statutes United States, section 5198, which provides that the taking of an unlawful rate of interest shall be deemed a forfeiture of the entire interest which the "bill or other evidence of debt carries with it," as this provision destroys the interest-bearing power of the instrument. Further, where the acceptor

conclusive of the subject. The federal statute itself, in section 5197, inhibited national banks from reserving other than the permissible interest, whether it was done by way of loan or by way of discount. The positive limitation of the section puts loans and discounts on the same identical basis. This of itself would prevent the application of the New York doctrine, and the negative answer to the inquiry given by the Court of Appeals was of necessity affirmed by the other tribunal. These were the only questions in that litigation. It is true that, in the course of the discussion concerning this matter, the court suggested that, when no rate of interest was fixed by the laws of the state, a bank could only charge seven per cent per annum. There are two reasons why that declaration by the court could not be taken as decisive of the present inquiry. As demonstrated, the case under consideration did not come up from a state where there was no statute fixing a rate, nor from one where the law fixed the rate, but permitted any rate to be charged which might be agreed upon between the parties. It came from a state having one fixed rate of interest, which, of course, under the federal statute, would be conclusive upon the rights of a national bank. In the next place, it was a statement *arguendo*, and could only be held to refer to a case where the laws of the state were silent." The court then discussed the state cases as follows: "Three of the cases presented the question in a somewhat different aspect from the one at bar, but one very illustrative of this theory of construction. They were actions upon notes reserving ten and twelve per cent interest, where the general rate was six, though the parties by contract were authorized to charge at the rate of ten and twelve per cent per annum. It was conceded that six was the general rate fixed by the statute, and that the other was totally dependent upon agreement of the parties; yet, the courts held that the national banks might reserve and receive whatever interest was allowed by the law of the state regulating the matter. Wiley *v.* Starbuck, 44 Ind. 298; Newell *v.* Bank, 12 Bush, 57; Crocker *v.* Bank, 1 Thomp. Nat. Bank Cas. 317; s. c., Fed. Cas. No. 3,397. It will be observed that in these cases the rate was established by the law of the state, and there was a limit put by the same laws, beyond which neither individuals nor banks could go. Within the limit, interest might be reserved. The courts, in reaching their conclusion, proceeded upon the hypothesis that, under the National Banking Act, the bank might charge any interest allowed by the laws of the state in which it was organized, even though the rate above six must be the subject of convention, and, unless the limit were reached, the rate as a rate would not be stated. This was regarded as of no moment in the interpretation of the statute. It is very plain that if the bank had reserved nine per cent, while the respective limits were six and ten, an amount would have been charged in a case where there was no definite legislation directly authorizing either the individual or the bank to charge nine per cent, other than that flowing from the

of such drafts makes a payment to the bank without any direction as to its application, the payment cannot be applied to the forfeited interest, but must be credited on the face value of the drafts.[1] The limitation of two years, within which an action, under the provisions of section 5198, Revised Statutes United States, may be commenced for the recovery from a national bank of twice the amount of money paid to it, dates from the actual payment of interest, and not from the bank's reservation of it from the original loan by way of discount.[2]

legislation which made the matter of interest between two definite limits a subject of convention. This distinction does not seem of very much consequence in the solution of the inquiry." "If it be true that, in a state where interest may be the subject of an agreement, the bank may reserve whatever the parties agree upon up to a maximum, then all statutes reserving the right of agreement of parties, whether they name a maximum or not, must be equally effectual for the purposes of a grant of power. The definite question under consideration has been expressly settled against the appellant in three different states. National Bank of Jefferson *v.* Bruhn, 64 Tex. 571; Hinds *v.* Marmolejo, 60 Cal. 229; Bank *v.* Stover, 60 Cal. 387; Guild *v.* Bank, (S. D.) 57 N. W. Rep. 499."

[1] Danforth *v.* National State Bank of Elizabeth, (1891) 48 Fed. Rep. 271.

[2] Smith *v.* First Nat. Bank of Crete, (Neb. 1894) 60 N. W. Rep. 866, following Bank *v.* Smith, 36 Neb. 199; s. c., 54 N. W. Rep. 254; followed in Lanham v. First Nat. Bank of Crete, (Neb. 1894) 60 N. W. Rep. 1041. The court referred to the few cases bearing upon the subject in these words: "In Duncan *v.* Bank, 1 Thomp. Nat. Bank Cases, 360; s. c., Fed. Cas. No. 4,135, KETCHAM, J., instructed the jury as follows: "From the origin of the loan — from the retaining of the first discount, through all the renewals, up to the time of final payment of the principal, or up to the time of entering judgments — there is a *locus penitentiæ* for the party taking the excessive interest. Any time till then he may consider the excessive interest paid on account of the loan, and so apply it, and lessen the principal. Up to that time he may make this election. When payment is actually made, and if, as in these cases, judgment is entered for the face amount of the notes or full amount of the loan, or payment is taken in full without any reduction by taking out the excessive interest, the cause of action is complete. The original loans in these cases were more than two years before these actions were brought, but the payment of one of the Millinger notes was made, and the judgments on all the Duncan & Bros.' notes were entered, near the time of bringing the suits, less than two years before. The payment and the judgment concluded the transaction, and determined their character to be usurious. Till that time it was undetermined, and the statute did not begin to run.'" In the case of Bank *v.* Davis, reported in Fed. Cas. No. 10,038, is found the opinion of GRESHAM, J., in which he quoted the section of the National Banking Act with which we have to deal. * * * Having quoted this language, Judge GRESHAM commented on it as follows: "If a national bank discount a note at a usurious rate of interest, paying the borrower the proceeds less the inter-

§ 295. A bank's duty as to securities deposited with it.—The findings of the court in this case were that the owners of certain bonds first placed them for safe-keeping with a firm of bankers. Afterwards they repeatedly asked for discounts of their notes by the bankers, offering them the bonds deposited with them as collateral, and the discounts were made. When the notes thus secured were paid the bankers called upon the owners of the bonds to know what they should do with them; they were informed that they were to hold them for the owners as previously. The owners had already written to the bankers that they desired to keep the bonds for an emergency, and also that they wished at times to overdraw their accounts, and that they would consider the bonds as security for such overdrafts. The court was of opinion from these facts that the bonds were held by the bankers as collateral security to meet any sums which the owners of the bonds might overdraw, and the accounts showed that they did subsequently overdraw in numerous instances. These bonds were originally sold by the bankers to the owners and left with them for safe-keeping. An absconding cashier of the bankers had stolen the bonds, and the owners brought this action to recover the value of the bonds of the bankers. The United States Supreme Court held that when bonds, originally deposited with the bankers for safe-keeping, were, by agreement of the bailors and bailees, made a standing security for the payment of loans to be made by the bank to the owners of the bonds, the bailees became bound to give such care to them as a prudent owner would extend to his own property of a similar kind.[1]

est, and suit be brought to recover the loan, and the borrower plead the usury, the bank will recover the face of the note, less the entire interest taken out, received, or reserved, and no more. It will thus collect the sum of money it actually paid out, being punished for receiving interest in excess of the legal rate by forfeiting all interest. But if the note thus discounted be renewed for the same amount, the borrower paying usurious interest out of his pocket in advance, and suit be brought on the renewed note, the defendant may recoup double the amount of the entire interest actually paid on renewal, or, in an independent action of debt, he may recover from the bank double the amount of the entire interest thus paid." In Higley *v.* First National Bank of Beverly, 36 Ohio St. 75, McIlvaine, J., on page 79 *et seq.*, made use of the following language, in reference to that part of the section above referred to: "By the first provision in that part of the section above quoted, if the contract or promise to pay usurious interest be unexecuted, it cannot be enforced, and in such case the debtor is released from the payment, not only of the interest in excess of the lawful rate, but 'the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon,' must be held and adjudged to be forfeited. By the latter provision, if usurious interest 'has been paid,' twice the amount of interest may be recovered back from the association 'taking or receiving' it, provided the action therefor be commenced within two years from the time the usurious transaction occurred. And, by construing the whole section together, we are inclined to believe that, in case usurious interest has been received at the time of the loan or discount, there is left to the bank a *locus penitentiæ*. In such case, the bank may, upon receiving payment of the debt, discharge itself from all liability to the debtor by giving credit for the amount of interest received; otherwise, the debtor may insist upon a reduction of his indebtedness to the amount actually loaned or advanced, or he may pay the whole claim, and afterwards, within two years, recover back twice the amount of interest paid." See Shinkle *v.* First National Bank of Ripley, 22 Ohio St. 516, which supports the above views. Other cases referred to are Hall *v.* Bank, 30 Neb. 103; s. c., 46 N. W. Rep. 150; Brown *v.* Bank, 72 Pa. St. 209.

[1] Preston *v.* Prather, (1891) 137 U. S. 604, affirming the judgment in favor of the plaintiff rendered in Prather *v.* Kean, 29 Fed. Rep. 498. The court referred to the following cases in support of their judgment, to wit: "In * * * Third National Bank *v.* Boyd, 44 Md. 47, it appeared that a firm * * * a large customer of [the bank] [*on a* certain date] was indebted to it in about five thousand dollars. Subsequently, the senior member of the firm, pursuant to an agreement between him and the president of the bank, deposited with the bank certain bonds and stocks as collateral security for the payment of all obligations of himself and of the firm then existing or that might be incurred thereafter, with the understanding that the right to sell the collaterals in satisfaction of such obligations was vested in the officers of the bank. Some of the bonds were subsequently withdrawn and others deposited in their places. While these collaterals were with the bank the firm kept a deposit account, having an average of about four thousand dollars, and from time to time, as it needed, obtained on the security of the collaterals discounts ranging from three to fifteen thousand dollars. The firm was not indebted to the bank subsequently to July, 1872, when it paid its last indebtedness; the bonds, however, were not then withdrawn, but left in the bank under the original agreement. In August, 1872, the bank was entered by burglars and certain of the bonds were stolen. In an action by the senior partner against the bank to recover the value of the bonds stolen it was held: 'First, that the contract entered into by the bank was not a mere gratuitous bailment. * * * Third, that the original contract of bailment being valid and binding, the obligation of the bank for the safe custody of the deposit did not cease when the plaintiff's debt had been paid. Fourth, that the defendant was responsible if the bonds were stolen in consequence of its failure to exercise such care and diligence in their custody and keeping as at the time banks of common prudence in like situation and business usually bestowed in the custody and keeping of similar property belonging to themselves; that the care and diligence ought to have been such as was properly adapted to the preservation and protection of the property,

§ 296. The rights of a bank as to securities pledged to it. — In this case it appeared that an agent, in pursuance of his principal's instructions, loaned money on pledges of personal property for which property he took warehousing receipts in his name as "agent." He then pledged these warehousing receipts to a bank to secure his individual debts to the bank, the latter having knowledge of the business relations between this agent and his principal and the operations in which they were engaged. The bank afterwards sold the goods represented by these warehousing receipts and applied the money to the payment of the debts of the agent who had pledged them to it. This action was brought by the owner, the principal of the pledgor, for the recovery of their value from the bank. The United States Circuit Court for the district of Maryland held that the knowledge above referred to, together with the use of the word "agent" on the receipts, was sufficient to put the bank upon inquiry, and it was liable to the principal for the amount realized by it from the sale of the goods.[1] The bank contended that the agent having

and should have been proportioned to the consequences likely to arise from any imprudence on the part of the defendant. Fifth, that the proper measure of damages was the market value of the bonds at the time they were stolen. Whether due care and diligence have been exercised by a bank in the custody of bonds deposited with it as collateral security, is a question of fact exclusively within the province of the jury to decide.' In * * * Cutting *v.* Marlor, 78 N. Y. 454, it appeared that the defendant, as collateral security for a loan made to him by a bank, delivered to it certain securities, which were taken and converted by the president to his own use. In an action by the receiver of the bank to recover the amount loaned, it was found that the trustees of the bank left the entire management of its business with the president and assistant, styled manager; that they received the statements of the president without question or examination; that they had no meetings pursuant to the by-laws, and made no examination of the securities, and exercised no care or diligence in regard to them; also, that the president had been in the habit of abstracting securities and using them in his private business, most of them being returned when called for; and that the manager, who had knowledge of this habit, did not take any means to prevent it, nor did he notify the trustees. It was held that the bank was chargeable with negligence, and that the defendant was entitled to counterclaim the value of the securities; that the bailment was for the material benefit of the parties; that the bailee was bound, for the protection of the property, to exercise ordinary care, and was liable for negligence affecting the safety of the collaterals, distinguishing the case from the liability of a gratuitious bailee, which arises only where there has been gross negligence on his part."

[1] Thurber *v.* Cecil National Bank, (1892) 52 Fed. Rep. 513. See as authority for this rule National Bank *v.*

authority to sell and the provisions of certain statutes of Maryland relieved it from liability. The court held that the fact that the agent had authority to sell did not affect the duty of the bank to make inquiry, as authority to sell did not include authority to pledge, nor was the bank excused from liability by the Maryland Factors' Act (Code, art. 2), providing that any person intrusted with storekeeper's certificates or other similar documents showing possession may pledge the goods to anybody who is without notice that such person is not the actual owner, the word "agent" in the receipts and the circumstances charging the bank with notice; nor by article 14 of the Maryland Code, declaring storage receipts to be negotiable instruments in the same manner as bills of lading and promissory notes; for when the fiduciary character of the holder is expressed on the face of a negotiable instrument notice is thereby given to the indorser that the holder *prima facie* has no right to pledge.[1] In this case the plaintiff's action was for certain coupon railroad mortgage bonds which it was claimed the bank became wrongfully and illegally possessed of. Plaintiff, the owner of these bonds, had placed them with certain brokers to cover margins in transactions in the purchase of stocks by them on his account. These brokers, keeping a regular account with the bank in their usual course of business, had placed these bonds with other securities as collateral with the bank under an agreement to this effect: "We hereby agree with the St. Nicholas National Bank of New York, in the city of New York, that in case we shall become or be at any time indebted to said bank for money lent or paid to us or for our account or use, or for any overdraft, in any sum or amount then due and payable, the said bank may, in its discretion, sell at the brokers' board or at public auction or private sale, without advertising the same, and without notice to us, all, any and every collateral securities, things in action and property held by said bank for securing the payment of such debt, and apply the proceeds to the payment of such indebtedness, the interest thereon, and the expenses of sale,

Insurance Co., 104 U. S. 54; Duncan *v.* Jaudon, 15 Wall. 165; Warner *v.* Martin, 11 How. 225; Taliaferro *v.* Bank, 71 Md. 208; s. c., 17 Atl. Rep. 1036; Lowry *v.* Bank, Taney, 310; Shaw *v.* Spencer, 100 Mass. 382; Dillon *v.* Insurance Co., 44 Md. 386.

[1] Ibid. In support of these rules see Allen *v.* St. Louis Bank, (1887) 120 U. S. 20, 32; s. c., 7 Sup. Ct. Rep. 460; Kinder *v.* Shaw, 2 Mass. 398; Phillips *v.* Huth, 6 Mees. & W. 572, 596; Cole *v.* North Western Bank, L. R., 10 C. P. 354, 363.

holding ourselves responsible and liable for the payment of any deficiency that shall remain unpaid after such application." The bank paid and advanced for these brokers on the faith of the bonds and other securities large sums of money. The brokers failed in business, and owed the bank a large sum for checks certified by it and outstanding, and for money paid by it up to the close of the business a few days before their failure. There was no notice or claim as to the ownership of the bonds involved by the alleged owner until two weeks after the failure of his brokers. The bank in good faith and on the best available terms made sale of the bonds and other securities and credited its depositors, the brokers, with the proceeds, which left a small deficiency which it never received. This case was tried on a circuit of the Supreme Court of the State of New York, and the plaintiffs asked the court to direct a verdict against the bank and in their favor on the ground that the certification of the checks by the bank was void, because it was unlawful, being a certification of checks drawn by the brokers when they had no money on deposit to their credit with the bank, and the bank could not hold the bonds as against such unlawful certification, and on the further ground that the bank did not take the bonds in the ordinary course of business. The trial court refused and directed a verdict for defendant. Exceptions to this judgment came before the Supreme Court in General Term, and the court denied a motion of plaintiffs for a new trial with an order that the defendant have judgment against the plaintiffs upon the verdict with costs.[1] The case was carried to the United States Supreme Court,

[1] Thompson *v.* St. Nicholas National Bank, (1888) 47 Hun. 621; affirmed in Thompson *v.* St. Nicholas National Bank, (1889) 113 N. Y. 325, in which case RUGER, Ch. J., remarked: "That the statute of the United States affirmed the validity of the contract of certification, and expressly provided the consequences which should follow its violation; that the penalty incurred was impliedly limited to a forfeiture of the bank's charter and the winding up of its affairs; that it was thus clearly implied that no other consequences were intended to follow a violation of the statute; and that it would defeat the very policy of an act intended to promote the security and strength of the national banking system, if its provisions should be so construed as to inflict a loss upon the banks and a consequent impairment of their financial responsibility." The court then cited to support that view National Bank *v.* Matthews, 98 U. S. 621; National Bank *v.* Whitney, 103 U. S. 99, and National Bank of Xenia *v.* Stewart, 107 U. S. 676. It was further said "that the statute in question had no application to the question involved in this suit, which concerned only the relations between [the brokers]

on a writ of error, there being a federal question involved, the construction and effect upon this contract of the United States Revised Statutes, section 5208, providing: "It shall be unlawful for any officer, clerk or agent of any national bank to certify any check drawn upon said bank, unless the person or company drawing said check shall have on deposit in said bank at the time such check is certified an amount of money equal to the amount specified in such check; and any check so certified by duly authorized officers shall be a good and valid obligation against such bank; and any officer, clerk or agent of any national bank violating the provisions of this act shall subject such bank to the liabilities and proceedings on the part of the comptroller as provided for in [the section of an act, the provisions of which were

and the [bank]; that by the deposit of the bonds the former secured the promise of the [bank] to protect their checks of a certain day for a specified amount; that the certification of the checks was entirely aside from the agreement between [the brokers] and the [bank], and was a contract between the [bank] and the anticipated holders of the checks; that [the brokers] had received the consideration of their pledge when the [bank] agreed with them to honor their checks, and that would have been equally effectual between the parties without any certification; that the certification was simply a promise to such persons as might receive the checks that they should be paid on presentation to the [bank]. in accordance with its previous agreement with [the brokers]; that the legal effect of the agreement was that the [bank] should loan a certain amount to [the brokers], and would pay it out on their checks to the persons holding such checks; that it was entirely legal for the [bank] to contract to pay [the brokers'] checks, and it did not affect the legality of that transaction that the [bank] also represented to third parties that it had made such agreement, nor could any other party standing in the shoes of [the brokers]; that the fact that the [bank], in connection with the agreement to pay such checks, had also promised third parties to pay them, could not invalidate the liability previously incurred, or impair the security which had previously been given to the [bank] upon a valid consideration; that the fact of the certification was entirely immaterial in respect to the liability incurred by [the brokers] to the [bank]; that there was no evidence impairing the title to the bonds acquired by the [bank] through the transfer of them to it by [the brokers]; that the purpose for which the bonds were transferred by [their original owner] to [the brokers] contemplated their transfer and sale by the latter to third persons; that the [bank] acquired a valid title to them by their transfer to it; that the transaction between [the brokers] and the [bank] was in the ordinary course of business pursued by the latter; that it received the bonds in good faith for a valuable consideration, and within all the authorities this gave it a good title to the bonds; that it was authorized to deal with them for the purpose of effecting the object for which they were transferred to it; that its right to hold the bonds continued so long as any part of its debt against

that the comptroller of the currency might forthwith appoint a receiver to wind up the affairs of the banking association]." The Supreme Court affirmed the decision of the New York Court of Appeals.[1] In this case a national bank in a failing condition, while being pressed by its customers, remitted securities in the form of bills of exchange, notes, etc., to a large amount to its correspondent bank in another city, on which it asked advances or loans for its relief and also authorized the holding of these securities as collaterals to protect against its overdrafts. The failing bank finally succumbed to the pressure, and was placed in the hands of a receiver. The receiver brought action against the bank holding these securities, claiming a right to their possession in himself as assets of the bank. The contention on the part of the receiver was that the United States Revised Statutes, sec-

[the brokers] remained unpaid; that the [original owner] could at any time have established his equitable right to a return of the bonds, and could have procured their surrender by paying the amount for which they were pledged, but he refrained from doing so, and impliedly denied any right in the [bank] by demanding the unconditional surrender of the bonds, and that he never became entitled to such surrender, and of course was not authorized to recover possession of them."

[1] Thompson *v.* St. Nicholas National Bank, (1892) 146 U. S. 240. Mr. Justice BLATCHFORD, for the court, approved the views of the New York Court of Appeals as sound and as covering the case. He then said: "The agreement [before referred to] between [the brokers] and the [bank] did not call for any act violating the statute. There was nothing illegal in providing that the securities which the bank might hold to secure the debt to it of [the brokers] should be available to make good such debt. The statute does not declare void a contract to secure a debt arising on the certificates which it prohibits. In addition to that, the statute expressly provides that a check certified by a duly authorized officer of the bank, when the customer has not on deposit an amount of money equal to the amount specified in the check certified, shall nevertheless be a good and valid obligation against the bank; and there is nothing in the statute which, expressly or by implication, prohibits the bank from taking security for the protection of its stockholders against the debt thus created. There is no prohibition against a contract by the bank for security for a debt which the statute contemplates as likely to come into existence, although the unlawful act of the officer of the bank in certifying may aid in creating the debt. In order to adjudge a contract unlawful, as prohibited by a statute, the prohibition must be found in the statute. The subjection of the bank to the penalty prescribed by the statute for its violation cannot operate to destroy the security for the debt created by the forbidden certification. If the [original owner] had pledged the bonds to the [bank], he could not, after receiving [the bank's] money, have replevied the bonds; and after possession of the bonds had been given by him to [the brokers], and after they had been subsequently taken by the [bank] in good faith, neither he, nor his executors can set up the statute to destroy the debt. This construction of the statute in question is strengthened by the subsequent enactment, making it a criminal offense in an officer, clerk or agent of a national bank to violate the provisions of the act. [Rev. Stats. U. S. § 5208, to wit: Act July 12, 1882, § 13, c. 288; 22 Stats. at Large, 166.] This shows that congress only intended to impose, as penalties for over certifying checks, a forfeiture of the franchises of the bank and a punishment of the delinquent officer or clerk, and did not intend to invalidate commercial transactions connected with forbidden certifications. As the [bank] was bound to make good the checks to the holders of them, because the act [heretofore referred to] declares that the checks shall be good and valid obligations against the [bank], it follows that [the brokers] were bound to make good the amounts to the [bank]. It necessarily results that the [bank], in paying the checks, was as much entitled to resort to the securities which [the brokers] had put into its hands, as it would have been to apply money which they might have deposited to meet the checks. Moreover, it has been held repeatedly by this court that where the provisions of the National Banking Act prohibit certain acts by banks or their officers, without imposing any penalty or forfeiture applicable to particular transactions which have been executed, their validity can be questioned only by the United States, and not by private parties. National Bank *v.* Matthews, 98 U. S. 621; National Bank *v.* Whitney, 103 U. S. 99, National Bank of Xenia *v.* Stewart, 107 U. S. 676. The bonds in question came into the possession of the [bank] before it certified the checks. They were not pledged to it under any agreement or knowledge on its part, or in fact on the part of [the brokers], that subsequent certificates would be made. The certificates were made after the pledge and created a debt of [the brokers], which arose after the pledge. The agreement [at the time of depositing the collaterals] applied and became operative simultaneously with the certifications, but independently of them, as a legal proposition. In Logan County Bank *v.* Townsend, 139 U. S. 67, 77, decided in March, 1891, after the present case was de-

tion 5242, which prohibits all transfers by any national banking association after the commission of an act of insolvency, or in contemplation thereof, with a view to the preference of one creditor to another, had been violated by the insolvent bank, and that the correspondent bank had, therefore, no title in or lien upon the securities which it held. WALLACE, J., of the United States Circuit Court for the southern district of New York, held that the statute was directed to preference, not to the giving of a security when a debt is created; and if the transaction be free from fraud in fact, and is intended merely to adequately protect a loan made at the time, the creditor can retain property transferred to secure such a loan until the debt is paid, though the debtor is insolvent, and the creditor has reason at the time to believe that to be the

fact.[1] In the same case the correspondent bank insisted that it acquired a banker's lien upon the securities for the amount of any balance upon its general account with the insolvent bank which remained unpaid. But the court held that a banker's lien for the amount of the balance of its general account does not exist when the securities have been deposited with the bank for a special purpose or for the payment of a particular loan.[2]

cided by the Court of Appeals of New York, this court approved the decision in National Bank *v.* Whitney, 103 U. S. 99, and said that a disregard by a national bank of the provisions of the act of congress forbidding it to take a mortgage to secure an indebtedness then existing, as well as future advances, could not be taken advantage of by the debtor, but 'only laid the institution open to proceedings by the government for exercising powers not conferred by law.'"

[1] Armstrong *v.* Chemical National Bank, (1890) 41 Fed. Rep. 234. It was said by the court: "The naked fact that the Fidelity Bank was insolvent at the time it sent the securities to the defendant does not imply that the transfer of the securities was made in contemplation of insolvency, or with a view of a preference of the defendant over its other creditors. Although, in the light of subsequent events, the Fidelity Bank was insolvent, it may be that its insolvency was not suspected by its officers. So far as appears no act of insolvency had been committed. A bank is not in contemplation of insolvency until the fact becomes reasonably apparent to its officers that it will presently be unable to meet its obligations, and will be obliged to suspend its ordinary obligations. Roberts *v.* Hill, 24 Fed. Rep. 571. Until this condition of affairs exists, certainly a national banking association does not violate the statute by pledging its securities to a reasonable amount to raise money needed to meet an unexpected run. The best managed institutions are liable to such contingencies, and the right to use their assets in an honest attempt to bridge over such a crisis is indispensable to their safety. Obviously the exercise of this right would be impracticable if the pledge becomes void whenever the attempt of the bank to rescue itself from failure becomes unsuccessful."

[2] Armstrong *v.* Chemical National Bank, (1890) 41 Fed. Rep. 234. WALLACE, J., said: "It is familiar law that a banker has a lien upon all funds and securities in his possession, deposited with him in the usual course of business by a customer to facilitate the financial transactions contemplated between them, which extends to the payment of any balance on general account. The lien arises from the implied understanding of the parties that credit is to be given in the course of dealings between them by the banker to the customer upon the faith of the securities. It is equally familiar law that the lien does not exist when the securities have been deposited for a special purpose, or for the payment of a particular loan; and where they are delivered specifically to protect the banker in a particular transaction, or series of transactions, he has no lien upon them for any other purpose, and cannot assert one for any other indebtedness whether arising upon general account or otherwise. This doctrine has recently been reiterated and applied by the Supreme Court in Reynes *v.* Dumont, 130 U. S. 354; s. c., 9 Sup. Ct. Rep. 486. That was a case

§ 297. Personal guaranty of a bank by stockholders and directors.— The United States Circuit Court of Appeals for the fifth circuit has held that a personal guaranty given by stockholders and directors of a bank to another bank in consideration of "loans, discounts or other advances to be made," for the repayment of any indebtedness thus created, imposed a liability on the guarantors when acted on by the guarantee, though no notice of acceptance of the guaranty was given, the contract showing a personal interest of the guarantors in the advances, constituting a consideration moving to them.[1]

§ 298. Misrepresentations by a bank as to solvency of a customer.— A state bank having loaned large sums of money to a manufacturing corporation upon representations made to it by a national bank through its cashier as to the good standing, etc., of the corporation, which were not repaid to the bank by reason of the insolvency of the corporation, brought its action against the national bank to recover damages for what it alleged

in which securities consisting of two hundred and seventy-five thousand dollars of municipal bonds had been left by one banking firm with another for a period of two years and a half, during which large transactions on general account took place between them; various loans were made to the former by the latter upon an express pledge of the bonds, and the former, at the request of the latter, had also obtained various loans of other bankers by pledging so many of the bonds as was necessary in the particular transaction. The court found as a fact that the bonds were left with the banking firm originally as collateral for a particular loan; that there was no express understanding between the two banking firms that they were to stand as a security for general transactions, and that the loans subsequently made upon them were specific loans accompanied by an express pledge, and held that these circumstances were inconsistent with the existence of a general lien. If the sending of the securities [in this case] had resulted, either in consequence of a subsequent express contract, or in consequence of any implication from the nature of the transaction, in giving the defendant a lien for the antecedent indebtedness of the [insolvent] bank, it is extremely doubtful whether the transaction could be upheld. The cases of Bank *v.* Colby, 21 Wall. 609, and Bank *v.* Butler, 129 U. S. 223; s. c., 9 Sup. Ct. Rep. 281, take a view of the statute which suggests that no preference can be obtained by one creditor of a national bank over another, after the bank has become insolvent, whether obtained with the consent of or by adversary proceedings against the bank and whether the creditor has or has not any reason to suppose the bank to be insolvent at the time."

[1] Doud *v.* National Park Bank of New York, (1893) 54 Fed. Rep. 846. See Davis *v.* Wells, 104 U. S. 159, for a review of the precedents in such case and a statement of their doctrine.

were fraudulent misrepresentations as to the standing, etc., of the corporation. Different defenses were made by the bank to this suit. Among others, it contended that neither the bank itself nor its cashier had power to make such representations as were made concerning the standing or credit of the corporation. The United States Circuit Court for the district of Oregon held that the national bank was liable for fraudulent representations made by it through its cashier to the other bank as to the financial responsibility of its customer.[1] There was a contention in this case, the letter containing the misrepresentations as to the credit of the corporation seeking loans being signed simply by the cashier of the national bank sued, that the action upon the representation was barred by the Statute of Frauds. The provision in the Code of Oregon, in substance a reproduction of Lord TENTERDEN's act (9 Geo. IV, chap. 14, § 6), was as follows: "No evidence is admissible to charge a person upon representation as to the credit, skill or character of a third party unless such representation or a memorandum thereof be in writing and either subscribed by or in the handwriting of the party to be charged." Under this contention arose the question whether the letter as written and signed by the cashier of the national bank was the

[1] Nevada Bank of San Francisco *v.* Portland Nat. Bank, (1893) 59 Fed. Rep. 338. GILBERT, Circuit Judge, said: "The defendants contend that the defendant bank, which is a national bank, had not the power to assume a liability for its own error or mistake in certifying to the financial standing of a customer seeking credit at another bank. It must be conceded that it had not the power to assume such liability *ex contractu*, but in the case of a tort committed by the bank or its officers a different principle is applied. In such a case it is the rule that the corporation is liable for the negligence or other tort of its agents and servants, even when performing acts that are *ultra vires*. In the case of Merchants' Bank *v.* State Bank, 10 Wall. 604, the court said: 'Corporations are liable for every wrong of which they are guilty, and in such case the doctrine of *ultra vires* has no application. Corporations are liable for the acts of their servants while engaged in the business of their employment in the same manner and to the same extent that individuals are liable under like circumstances.' In Bank *v.* Graham, 100 U. S. 699, 702, the court said: 'An action may be maintained against a corporation for its malicious or negligent torts, however foreign they may be to the object of its creation, or beyond its granted powers. It may be sued for assault and battery, for fraud and deceit, for false imprisonment, for malicious prosecution, for nuisance and for libel.'" The same doctrine is applied in the cases of Railroad Co. *v.* Derby, 14 How. 468; Railroad Co. *v.* Quigley, 21 How. 202; Etting *v.* Bank, 11 Wheat. 59; Bissell *v.* Railroad Co., 22 N. Y. 258.

letter of the bank and the signature the signature of the bank within the meaning of this statute. The court held that it was.[1]

[1] Nevada Bank of San Francisco *v.* Portland Nat. Bank, (1893) 59 Fed. Rep. 338. GILBERT, Circuit Judge, *arguendo*, said: "It is argued that the signature of the cashier of the defendant bank, attached to the letters, is not the signature of the bank. The English case of Swift *v.* Jewsbury, L. R., 9 Q. B. 301, decided in 1874, is relied upon as giving that interpretation to the statute. In that case a letter had been written to the manager of a bank, requesting his opinion of the standing of one who was seeking credit. The answer was signed 'J. B. Goddard, Manager.' The banking company had no knowledge that such letter had been written, and gave the manager no express authority to write the same. The company was not a corporation. It was a copartnership, with certain privileges conferred by statute. It could sue and be sued only in the name of one of its public officers, and its members could not be made liable in respect to transactions with the company until a judgment had first been obtained against the company through one of its public officers. The decision of the Court of Queen's Bench was that the signature of Goddard, the manager, was in fact and law the signature of the banking company; but upon appeal to the Court of Exchequer, Lord COLERIDGE was of the opinion that the signature to the document upon which the bank was sought to be held liable was not signed by the party to be charged, and did not come within the terms of the statute. Instead of basing the decision upon that view of the law, however, he held that the decision of the Queen's Bench should be reversed upon the ground that upon the language of the correspondence there was no intention to consult the bank, but rather the manager thereof; and that the representation was made by Goddard himself of matters as to which he was pledging his personal knowledge only. Upon this ground the decision was concurred in by the remainder of the court. No American case is found which covers the point in question, but the tendency of the decisions in the states in which Lord TENTERDEN's act has been adopted has been to modify the protection which the statute affords to fraud by enforcing a strict construction of its provisions. Bush *v.* Sprague, 51 Mich. 41; s. c., 16 N. W. Rep. 222; Hodgin *v.* Bryant, 114 Ind. 401: s. c., 16 N. E. Rep. 815. * * * A corporation can sign instruments in writing only by an officer or officers empowered so to do. In the usual course of the corporation's business the act of signing is not the act of an agent but the act of the corporation itself. While formal documents are usually signed by the president and secretary, and further authenticated by the corporate seal, the corporation may, nevertheless, empower any officer to execute deeds or other instruments in writing. In banking corporations, most instruments in writing issued or indorsed by the bank are signed by the cashier. The letters of the bank, in its usual correspondence about business are often, if not generally, signed by him. In Morse on Banks and Banking (§ 162) it is said that it is the special duty of the cashier to conduct the correspondence of the bank. The name of the defendant bank stands at the head of both letters referred to in the complaint, and both are signed by the cashier, and his official title is appended. The question is not free from doubt, but I am inclined to the view that in a document of this kind, written under the circumstances detailed in the complaint, the signature of the cashier is the signature of the bank."

CHAPTER X.

OFFICERS OF BANKS.

§ 299. Directors — their powers and duty.
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§ 299. Directors — their powers and duty.— Directors of a bank may authorize one of their number to assign any securities belonging to the corporation.[1] The directors of a bank have authority to settle with its cashier, where his accounts exhibit a deficiency in the funds; and, if the directors be guilty of fraudulent conduct in the settlement made with him, the settlement would still be valid, where the cashier is not shown also to be guilty of fraud.[2] But if the cashier be guilty of fraud in connection with the settlement, the bank will not be concluded by it.[3] Directors of a bank have no authority to allow overdrafts.[4] The giving of compensation to a director by the board of directors of a bank for extra services, though unlawful, will not expose the directors to liability if done in good faith and with the purest intention to benefit the bank.[1] A director of a bank receiving his compensation provided by law as a director cannot contract with the board of directors while he continues a member for compensation for extra services.[2] But a board of directors of a bank may compensate a member of the board for services rendered to the bank prior to his membership.[3] Where a director of a bank has received money by order of its board of directors, which is unauthorized by law, it may be recovered by the bank as so much received to its use.[4] A bank will be affected with the knowledge of one of its directors, who acts for it in discounting a note, that the note was procured by fraud.[5] Where the director having knowledge of the character of negotiable paper discounted by a bank simply recommends its discount, the bank will not be charged with his knowledge if the director does not control its discretion or discount the paper himself as an officer or agent of the bank.[6] The directors of banks are bound to constant activity and thorough acquaintance with the daily course of affairs and dealings of the institution. They are bound, in the absence, illness or negligence of the cashier, to perform any duty which belongs to him, and it is their duty to see that the duty is performed. They are bound in law to know the securities of the bank, its bills payable and bills receivable, maturity of its paper

[1] Northampton Bank *v.* Pepoon, (1874) 11 Mass. 288.

[2] Frankfort Bank *v.* Johnson, 24 Me. 490.

[3] Ibid.

[4] Market Street Bank *v.* Stumpe, (1876) 2 Mo. App. 545. As to powers of the directors of a bank, see Harper *v.* Calhoun, 7 How. (Miss.) 203; State *v.* Commercial Bank of Manchester, 6 Smedes & Marsh. (Miss.) 218; Commercial Bank of Manchester *v.* Bonner, 13 Smedes & Marsh. (Miss.) 649.

[1] Godbold *v.* Branch Bank at Mobile, 11 Ala. 191.

[2] Branch Bank at Mobile *v.* Collins, (1845) 7 Ala. 95; Branch Bank at Mobile *v.* Scott, (1845) 7 Ala. 107. An order of a board of directors allowing a compensation of $1,000 cash to the members of the board constituting the real estate committee, has been held to be illegal and void in Branch Bank at Mobile *v.* Collins, (1845) 7 Ala. 95; Branch Bank at Mobile *v.* Scott, (1845) 7 Ala. 107.

[3] Branch Bank at Mobile *v.* Collins, (1845) 7 Ala. 95; Branch Bank at Mobile *v.* Scott, (1845) 7 Ala. 107.

[4] Branch Bank at Mobile *v.* Collins, (1845) 7 Ala. 95; Branch Bank at Mobile *v.* Scott. (1845) 7 Ala. 107.

[5] Security Bank *v.* Cushman, (1877) 121 Mass. 490. Under what circumstances a bank would not be affected by the knowledge of one of its directors in discounting a note, see Washington Bank *v.* Lewis, (1839) 22 Pick. (Mass.) 24. When notice to a director of facts affecting paper offered for discount is notice to the bank, see Clerks' Savings Bank *v.* Thomas, (1876) 2 Mo. App. 367. As to a notice to a bank director, or knowledge obtained by him while not engaged either officially or as an agent or attorney in the business of the bank, being inoperative as a notice to the bank, see Fairfield Savings Bank *v.* Chase, 72 Me. 226.

[6] Shaw *v.* Clark, 49 Mich. 384.

and who are the parties. And, in the absence of the cashier, they are bound to due diligence in perfecting the liability of all indorsers upon the paper of the bank.[1] The doctrine, that the directors of a bank are conclusively presumed to know the financial condition of the bank, its general business and its receipts and expenditures as shown by its regular books, is for the protection of third parties dealing with the bank and of the bank against the prejudicial action of any director, and cannot be invoked to uphold a wrong appropriation of moneys by the cashier or other officer, which appropriation may be made and also entered upon the books of the bank without the actual knowledge of the directors.[2] The sacrifice of the corporate property by officers of a bank for the purpose of passing a crisis in its affairs, can only be justified when the object is to protect the rights of the creditors and do equal justice to all the stockholders of the corporation. The act must not be for the exclusive benefit of a particular individual, especially if it be one to whom the management of the funds of the bank has been intrusted.[3] Where the obligations for loans held by a bank against its directors exceeded the limit prescribed by law, and the cashier to reduce them procured notes to be made and indorsed for his accommodation, and had them substituted and absolutely exchanged for notes indorsed by a director and discounted by the bank for his accommodation, the Supreme Court of New York held that the transaction, being in good faith and not a mere shift to present a temporary appearance of soundness, was legal and the new notes valid.[4] Directors of a bank under the Maine statutes are liable to a creditor of the bank suffering certain losses growing out of the official mismanagement of the directors. These directors are personally responsible for the official mismanagement only which may have occurred during the year for which they were to have been chosen and during which they have acted.

[1] Lane *v.* Bank of West Tennessee, 9 Heisk. (Tenn.) 419; Moses *v.* Ocoee Bank, 1 Lea (Tenn.), 398.

[2] First National Bank *v.* Drake, (1883) 29 Kans. 311. As to the diligence required of directors of a bank in acquiring knowledge of its business, and what negligence would render them liable for special deposits lost by the bank, see United Society of Shakers *v.* Underwood, (1873) 9 Bush (Ky.), 616.

[3] Gillet *v.* Moody, 3 N. Y. 479.

[4] Seneca County Bank *v.* Neass, (1848) 5 Denio, 329. As to loans of bank funds to directors, see Bank Commissioners *v.* Bank of Buffalo, (1837) 6 Paige Ch. 497.

They are personally answerable for ordinary neglect in their official business. But one board of directors cannot be made to answer for renewals of worthless paper discounted by a previous board.[1] In a rather recent case, an action by bill of the receiver of a national bank against its former directors and the representatives of such as were deceased, framed upon the theory of a breach by the defendants as directors "of their common-law duties as trustees of a financial corporation and of breaches of special restrictions and obligations of the National Banking Act," the questions of the management of the business of such institution and the liability of its directors have been fully considered in the main opinion by the majority of the Supreme Court of the United States, and the dissenting opinion of the minority. It appeared that the provisions of the by-laws were not observed, and that the management of the bank was left almost entirely to the officers. No exchange committee nor examination committee was appointed, and the meetings of the board were infrequent and perfunctory. For years prior to the failure, fourteen at least, the business of the bank had been conducted by the president. Fuller, Ch. J., speaking for the majority, said: "It is not contended that the defendants knowingly violated, or permitted the violation of, any of the provisions of the Banking Act, or that they were guilty of any dishonesty in administering the affairs of the bank, but it is charged that they did not diligently perform duties devolved upon them by the act. Our attention has not been called, however, to any duty specifically imposed upon the directors as individuals by the terms of the act, although if any director participated in or assented to any violation of the law by the board he would be individually liable. The corporation after the amendment of 1874 had power to carry on its business through its officers. And although no formal resolution authorized the president to transact the business, yet, in view of the practice of fourteen years or more, we think it must be held that he was duly authorized to do so. It does not follow that the

[1] Bank Mutual Redemption *v.* Hill, 56 Me. 385. That directors of a bank, after its insolvency, have no rights in equity to secure any advantage to themselves, see Roan *v.* Winn, (1887) 93 Mo. 503. As to liability of directors of a bank who may have allowed a bank to be damaged by wrongful acts of its president, see Smith *v.* Rathbun, 22 Hun, 150. As to liability of directors of a bank to depositors for their gross negligence and mismanagement, see Adams *v.* Manning, 10 W. N. C. (Pa.) 449.

executive officer should have been left to control the business of the bank absolutely and without supervision, or that the statute furnishes a justification for the pursuit of that course. Its language does enable individual directors to say that they were guilty of no violation of a duty directly devolved upon them. Whether they were responsible for any neglect of the board as such, or in failing to obtain proper action on its part is another question. Indeed, it is frankly stated by counsel that 'although special provisions of the statute are quoted and relied upon, these do not create the cause of action, but merely furnish the standard of duty and the evidence of wrong-doing,' and section 556 of Morawetz on Corporations is cited, which is to the effect that 'the liability of directors for damages caused by acts expressly prohibited by the company's charter or act of incorporation is not created by force of the statutory prohibition. The performance of acts which are illegal or prohibited by law may subject the corporation to a forfeiture of its franchises, and the directors to criminal liability, but this would not render them civilly liable for damages. The liability of directors to the corporation for damages caused by unauthorized acts rests upon the common-law rule which renders every agent liable who violates his authority to the damage of his principal. A statutory prohibition is material under these circumstances merely as indicating an express restriction placed upon the powers delegated to the directors when the corporation was formed.' It is perhaps unnecessary to attempt to define with precision the degree of care and prudence which directors must exercise in the performance of their duties. The degree of care required depends upon the subject to which it is to be applied, and each case has to be determined in view of all the circumstances. They are not insurers of the fidelity of the agents whom they have appointed, who are not their agents, but the agents of the corporation, and they cannot be held responsible for losses resulting from the wrongful acts or omissions of other directors or agents, unless the loss is a consequence of their own neglect of duty, either for failure to supervise the business with attention or in neglecting to use proper care in the appointment of agents. Morawetz, § 551 *et seq.*, and cases. Bank directors are often styled trustees, but not in any technical sense. The relation between the corporation and them is rather that of principal and agent, certainly so far as

creditors are concerned, between whom and the corporation the relation is that of contract and not of trust. But, undoubtedly, under circumstances, they may be treated as occupying the position of trustees to *cestui que trust*." After referring to the cases cited below,[1] the majority of the court applied, through the chief justice, these principles to the particular acts of particular ones of the directors charged in the bill with neglect and relieved them from liability as charged.[2] Four of the justices, however, dissented as to the acts of several of the directors.[3]

[1] Percy *v.* Millaudon, 8 Mart. (N. S.) (La.) 68; Spering's Appeal, 71 Pa. St. 11; Citizens' Building Association *v.* Coriell, 34 N. J. Eq. 383; Hodges *v.* New England Screw Co., 1 R. I. 312; Wakeman *v.* Dalley, 51 N. Y. 27.

[2] Briggs *v.* Spaulding, (1891) 141 U. S. 132.

[3] Ibid. Mr. Justice HARLAN, speaking for himself and GRAY, BREWER and BROWN, JJ., in the dissenting opinion, presented their conclusions in these words: "We are of opinion that when the act of congress declared that the affairs of a national banking association shall be 'managed' by its directors, and that the directors should take an oath to 'diligently and honestly administer' them, it was not intended that they should abdicate their functions and leave its management and the administration of its affairs entirely to executive officers. True, the bank may act by 'duly authorized officers or agents,' in respect to matters of current business and detail that may be properly intrusted to them by the directors. But, certainly, congress never contemplated that the duty of directors to manage and to administer the affairs of a national bank should be in abeyance altogether during any period that particular officers and agents of the association are authorized or permitted by the directors to have full control of its affairs. If the directors of a national bank choose to invest its officers or agents with such control, what the latter do may bind the bank as between it and those dealing with such officers and agents. But the duty remains, as between the directors and those who are interested in the bank, to exercise proper diligence and supervision in respect to what may be done by its officers and agents. As to the degree of diligence and the extent of supervision to be exercised by directors, there can be no room for doubt, under the authorities. It is such diligence and supervision as the situation and the nature of the business requires. Their duty is to watch over and guard the interests committed to them. In fidelity to their oaths and to the obligations they assume, they must do all that reasonably prudent and careful men ought to do for the protection of the interests of others intrusted to their charge." The justice, in support of the conclusions of the minority, quoted largely from many of the following cases, and cited the others: Martin *v.* Webb, 110 U. S. 7; Cutting *v.* Marlor, 78 N. Y. 454; Preston *v.* Prather, 137 U. S. 604; Hun *v.* Cary, 82 N. Y. 65; Ackerman *v.* Halsey, 37 N. J. Eq. 356; Halsey *v.* Ackerman, 38 N. J. Eq. 501; United Society of Shakers *v.* Underwood, 9 Bush (Ky.), 609; Horn Silver Co. *v.* Ryan, 42 Minn. 196; United States *v.* Means, 42 Fed. Rep. 599; Delano *v.* Case, 121 Ill. 247; Percy *v.* Millaudon, 3 La. 568; Marshall *v.* F. & M. Savings Bank of Alexandria, etc., 85 Va. 676;

§ 300. Jurisdiction of state courts in cases of directors of national banks violating their duty.— This being a case against the directors of a national bank which, being insolvent and in the hands of the receiver, defendant here, the demurrer to the bill challenged the jurisdiction of the state court. To this it was said: "The right of action is not, in our opinion, derived from the act of congress, but depends upon general principles of equity, but in any aspect of the case, the state courts have concurrent jurisdiction, unless exclusive jurisdiction has been conferred upon the United States courts.[1] The jurisdiction of the state courts over actions against national banks is expressly recognized by the act, and such jurisdiction has been repeatedly exercised in actions by receivers to collect claims due to such banks. There can be no reason why civil actions brought by stockholders in place of the receiver, to enforce claims against delinquent directors or officers, should stand upon any different footing. The only cases in which exclusive jurisdiction is conferred, by the Banking Act, upon the courts of the United States, so far as we can find, are proceedings to enforce the forfeiture of the franchises of banking associations for violations of the act (§ 5239), and proceedings to enjoin the comptroller of the currency from winding up the corporation, through a receiver. There is nothing in the act which withdraws from the jurisdiction of the state courts civil actions to enforce rights of individuals against national banks or their officers.[2] Criminal prosecutions for offenses created by the act stand upon a different footing. Exclusive jurisdiction in such cases is vested in the Circuit and District Courts of the United States by the Judiciary Act of 1789." As to parties, it was also said: "The bank was a proper and even necessary party defendant. Robinson *v.* Smith, 3 Paige, 222. It continued to be a corporation, notwithstanding the appointment of a receiver, and the receiver may bring action in its name. Pahquioque Bk. *v.* Bethel Bk., 36 Conn. 325; Kennedy *v.* Gibson, 8 Wall. 506; Green *v.* Walkill Nat. Bk., 7 Hun, 63; City of Lexington *v.* Butler, 14 Wall. 283; Bank *v.* Kennedy, 17 Wall. 19. The receiver was also a necessary party, as it was through him that the amount which might be adjudged against the directors was to be collected and paid over. The presence of both of these parties was necessary to a final determination of the controversy."[1]

Building Fund Trustees *v.* Bosseiux, 3 Fed. Rep. 817; Charitable Corporation *v.* Sutton, 2 Atk. 400; Land Credit Co. of Ireland *v.* Lord Fermoy, L. R., 5 Ch. 763; Williams *v.* McKay, 40 N. J. Eq. 189.

[1] Citing Claflin *v.* Houseman, 93 U. S. 130; Robinson *v.* National Bank of Newberne, 81 N. Y. 385; National Bank of Gloversville *v.* Wells, 79 N. Y. 498; affirmed in the Supreme Court of the United States, January, 1882.

[2] Citing Cooke *v.* State Nat. Bank of Boston, 52 N. Y. 96; Bletz *v.* Columbia Nat. Bank, 87 Pa. St. 87.

§ 301. Jurisdiction of courts of equity in such cases.— The New York Court of Appeals has sustained the jurisdiction of courts of equity of suits to enforce the liability of directors of corporations growing out of a violation of their duties in allowing or promoting the waste of corporate funds, for instance. Upon this subject RAPALLO, J., for the court, said: "The liability of directors of corporations for violations of their duty or breaches of the trust committed to them, and the jurisdiction of courts of equity to afford redress to the corporation, and in proper cases to its shareholders, for such wrongs exist independently of any statute. By the Revised Statutes of New York (2 R. S. 462) it is declared that the chancellor has jurisdiction over directors, managers and other trustees, and officers of corporations, and to compel them to account for their official conduct in the management and disposition of the funds and property committed to their charge, and to compel payment by them to the corporation whom they represent, of all sums of money, and the value of all property which they may have acquired to themselves or transferred to others, or may have lost or wasted by any violation of their duties as such trustees. These enactments are, however, merely declaratory of a jurisdiction long previously conceded to exist, both in this state and in England, and to them were added by further provisions of the Revised Statutes certain visitorial powers not before exercised by the Court of Chancery (except in cases of charitable bodies), viz., to restrain corporations from exceeding their corporate powers. This latter jurisdiction was that which the Court of Chancery disclaimed in the well-known case of The Attorney-General *v.* The Utica Ins. Co., 2 Johns. Ch. 389, with reference to which case the provisions of the Revised Statutes just referred to were framed. But, in that very case, jurisdiction in cases like the present was conceded

[1] Brinkerhoff *v.* Bostwick, (1882) 88 N. Y. 52, 60, 61.

to be inherent in the court, and in Robinson *v.* Smith, 3 Paige, 222, 233, the power is declared to exist independently of the provisions of the Revised Statutes, so far as the individual rights of stockholders are concerned, to call directors to account and make satisfaction for losses occasioned by breaches of their trust. This jurisdiction has been continually exercised in England and in this country, and is not of statutory origin. Angell & Ames on Corp. § 312, and cases cited."[1]

[1] Brinkerhoff *v.* Bostwick, (1882) 88 N. Y. 52, 58, 59. See, also, Brinckerhoff *v.* Bostwick, (1885) 99 N. Y. 185. As to how such actions may be brought, it was said in Brinkerhoff *v.* Bostwick, 88 N. Y. 52: "The action to recover such losses, as before observed, should in general be brought in the name of the corporation, but, if it refuses to prosecute, the stockholders, who are the real parties in interest, will be permitted to sue in their own names, making the corporation a defendant. Greaves *v.* Gouge, 69 N. Y. 154. And that course of proceeding is also allowed if it appears that the corporation is still under the control of those who must be made the defendants in the suit. See Butts *v.* Wood, 37 N. Y, 317; Robinson *v.* Smith, 3 Paige, 222. In such cases a demand upon the corporation to bring the suit would be manifestly futile and unnecessary. A suit prosecuted under the direction and control of the very parties against whom the misconduct is alleged, and a recovery is sought, would scarcely afford to the shareholders the remedy to which they are entitled, and the fact that the delinquent parties are still in control of the corporation is of itself sufficient to entitle the shareholders to sue in their own names. Hodges *v.* New England Screw Co., 1 R. I. 312; Heath *v.* Erie Railway Co., 8 Blatchf. 347. If they could not be permitted in such cases to assert their own rights in a court of equity, the directors so long as they remained in office could set them at defiance. In the present case the corporation cannot sue, because all its rights of action have been transferred by operation of law to the receiver. He certainly is not a proper person to whom to intrust the conduct of the action, even did he consent to institute it, or should the comptroller of the currency direct him so to do, for he is one of the parties charged with misconduct and against whom a remedy is sought. It necessarily follows that the shareholders must be permitted to sue in their own names, or the wrongs complained of must go without redress, and substantial rights be sacrificed to a mere matter of form. The shareholders are the parties whose interests are involved in the proceeding. If conducted in the name of the corporation or the receiver, it would be as their representative and for their benefit; and when, as in this case, sufficient reasons are shown why it cannot be effectually prosecuted in that form, the right of the shareholders to sue in their own names is sanctioned by principle and precedent. Where the shareholders are numerous, the suit may be brought by one or more in behalf of all." Butts *v.* Wood, 37 N. Y. 317; Robinson *v.* Smith, 3 Paige, 222; Hichens *v.* Congreve, 4 Russ. 562; Heath *v.* Erie Railway Co., 8 Blatchf. 347. More than sixty years ago Chancellor WALWORTH, of the Court of Chancery of New York, referring to the allegations of the bill before him said: "If [they] are true, there is no doubt that the directors of this company were guilty of a most palpable violation of their duty, in engaging in this gambling speculation in stocks, which was wholly unauthorized by their charter, and which, the bill alleges, was carried on to subserve their own individual interests and purposes. I have no hesitation in declaring it as the law of this state that the directors of a moneyed or other joint-stock corporation, who willfully abuse their trust or misapply the funds of the company, by which a loss is sustained, are personally liable as trustees to make good their loss. And they are equally liable, if they suffer the corporate funds or property to be lost or wasted by gross negligence and inattention to the duties of their trust." Robinson *v.* Smith, (1832) 3 Paige Ch. 222, 232. Adopting and approving this rule declared by Chancellor WALWORTH, the Court of Appeals has since held that a complaint charging the directors of a national bank with neglecting to perform their official duties as such directors, and negligently permitting the money, property and effects of the bank to be stolen, wasted and squandered; with negligently permitting various persons and corporations who were insolvent and irresponsible to overdraw their accounts to a large amount without security, and negligently permitting the money of the bank to be loaned to irresponsible persons and corporations, without adequate security, whereby said money was lost; with employing a cashier who was dishonest, unfaithful and incompetent, all of which was known to them; with neglecting to take and keep good and sufficient security for the performance of the duties of said cashier and of the president and other officers of the bank; and that they so negligently and carelessly conducted its affairs that its entire capital, surplus, property and effects were lost and the stock rendered worthless, and the stockholders were rendered liable for a large sum of money on account of the unpaid debts of the bank, stated a cause of action upon the personal liability of directors.

§ 302. Statutory liability of directors of national banks — actions to enforce it — rules. — The personal liability of directors of a national bank for violation of the Revised Statutes of the United States, section 5204, by declaring dividends in excess of net profits, and of section 5200 for loaning to separate persons, firms or corporations amounts exceeding one-tenth of the capital stock, cannot be enforced in an action at law.[1] Under the Revised Statutes of the United States, section 5239, providing that, if the directors of a national bank shall violate any of the provisions of the title relating to the organization and management of banks, the franchises of the bank shall be forfeited, such violation, however, to be determined by a proper court of the United States in

[1] Welles *v.* Graves, (1890) 41 Fed. Rep. 459, in accordance with the doctrine laid down in Hornor *v.* Henning, 93 U. S. 228. See Stone *v.* Chisolm, 113 U. S. 302; s. c., 5 Sup. Ct. Rep. 497.

a suit therefor by the comptroller, and that in cases of such violation every director participating therein shall be personally liable for all damages which the bank, its shareholders, or any other person shall have sustained in consequence thereof, the comptroller cannot authorize the receiver of any such bank to bring suit under section 5234 to enforce such personal liability until it has been adjudged by a proper court that such acts have been done as authorized a forfeiture of the charter.[1] Directors of a national bank have been held personally liable as provided by section 5239 of the Revised Statutes of the United States for damages sustained in consequence of excessive loans where they had assented to a loan in excess of the limit prescribed by section 5200 of the Revised Statutes of the United States, and subsequently retired paper representing a part of this loan by charging it against an illegal dividend, declared when the bad paper reckoned to make up an apparent surplus more than exceeded the capital stock, which transaction was invalid, the liability being fixed at the amount of the paper thus retired.[2] An action under the act of congress imposing a legal liability on the directors of a national bank for certain things which they do which shall result in an injury to the bank, its stockholders or creditors, and making them liable for the amount of the damages, survives against the estate of a director, the statute being a remedial and not a penal statute.[3] It is no defense to an action by the receiver of a bank against a director's estate, such bank director having made a wrongful loan of money from which loss occurred, that the insolvency of the person to whom the loan was made was not discovered until after the death of the director and the appointment of the receiver.[4] Directors of an insolvent national bank which has been placed in the hands of a receiver are not amenable to a suit by a stockholder in the bank to make them personally liable for the mismanagement of the bank, such right of action being in the receiver and not in the individual stockholder.[5] The receivers of a railroad company in Texas had

[1] Welles *v.* Graves, (1890) 41 Fed. Rep. 459. See Kennedy *v.* Gibson, 8 Wall. 498.

[2] Witters *v.* Sowles, (1890) 43 Fed. Rep. 405.

[3] Stephens *v.* Overstolz, (1890) 43 Fed. Rep. 465.

[4] Ibid.

[5] Howe *v.* Barney, (1891) 45 Fed. Rep. 668. In National Exchange Bank of Baltimore *v.* Peters, (1890) 44 Fed. Rep. 13, HUGHES, Circuit Judge, referring first to the statutes, discussed this question elaborately as follows:

under the orders of the federal court appointing them deposited large amounts of money in a bank in that state. This bank became insolvent and its affairs were in the hands of a receiver appointed by a state court. The balance of funds due receivers on their deposit account not being paid on demand, they petitioned the court appointing them, alleging a conspiracy on the part of several officers of that bank to misappropriate the funds,

"Thus the statute law makes directors of a national bank liable in damages for violations of their duty, or negligence or malfeasance as directors, and prescribes how they shall be subjected to liability. Being liable in damages, they are amenable to suit for damages in a jury proceeding, and not, I infer, to suit in any other form, whether at law or in equity. But even if they were amenable to liability in a proceeding not sounding in damages, then, the damages recoverable being an asset of the bank, the statute law empowers and requires the receiver of the injured bank, under the direction of the comptroller, and him alone, to sue the claim. Except the receiver, the statute law nowhere authorizes suit to be brought by any person not in privity against directors of national banks. The bill of complaint under consideration has, therefore, no sanction in respect to its party plaintiff from the statute law of the land. Does it present a case in which equity, in the exercise of a high prerogative to which it feels at liberty sometimes to resort, will relieve against the rule of privity, and entertain this suit, though brought by a plaintiff otherwise incompetent to sue? Certainly the bill contains nothing on its face to require or to justify such a recourse. Exceptional authority to sue is given only in the rare cases in which those legally competent to sue wrongfully refuse to do so. When such a case is presented, equity will sometimes authorize and direct suit to be brought by some other plaintiff whom it may approve. As before said, whatever is claimed in the suit at bar would be an asset in the hands of the receiver if recovered, and the statute law imposes upon him the duty of suing for it, under the comptroller's direction. But this bill contains no allegation either that complainant called upon the comptroller to direct the receiver to sue, and he refused, or that the receiver himself was called upon and refused. Containing no such allegation, the bill makes no case for a suit by a person other than the receiver. Nor would it follow, even if such an application had been made and refused, and the fact had been only alleged in the bill, that this suit could be maintained, for in cases where directors of national banks have violated or negligently permitted the violation of the laws regulating those banks, the statute law seems to require that the question of violation shall be judicially determined in a proper court of the United States, in a suit instituted in his own name by the comptroller for that specific purpose, before the liability can attach to the directors; and, therefore, it would seem that directors cannot be pursued individually for such violation until after such an adjudication thus obtained. So that if the receiver and the comptroller, though called upon to sue the defendants in this suit, had refused to do so, even the allegation of such application and refusal would have been insufficient ground of authority for bringing this suit. I am of the opinion that the provisions of the National Banking

the making of securities to themselves for alleged personal debts against the bank and the appointment of a receiver, and asked that these officers of the bank be punished as in contempt of the court. The rule for contempt was discharged, but an order was laid upon the receivers to institute such proceedings as might be necessary to make the respondents individually and collectively liable for all the funds wrongfully obtained from and withheld from the receivers.[1]

Act enter as part into the contracts of creditors with the national banks, and that those provisions which define the liability of directors, and prescribe the proceedings to be taken against them, when guilty of violations of the act, are exclusive of other liability and other proceedings; and that it is not within the prerogative of equity to authorize a disregard of the provisions of the National Banking Act, defining such liability and prescribing such proceedings." See, on this point, Smith *v.* Hurd, 12 Met. 371; Craig *v.* Gregg, 83 Pa. St. 19; Allen *v.* Curtis, 26 Conn. 455; Evans *v.* Brandon, 53 Tex. 56. As to the circumstances under which a stockholder may bring such actions, see Robinson *v.* Smith, 3 Paige, 222; Brinkerhoff *v.* Bostwick, 88 N. Y. 52; Smith *v.* Poor, 40 Me. 415; Carter *v.* Glass Co., 85 Ind. 180. As to the avails of such litigation by stockholder going to the corporation and being a part of its means, see Dewing *v.* Perdicaries, 96 U. S. 193, 197, 198.

[1] Southern Development Co. *v.* Houston & Texas Central Ry. Co., (1886) 27 Fed. Rep. 344. PARDEE, J., said: "Counsel for the receivers contend that the effect of the order of court designating the bank as one of the depositories of the receivers, and the acceptance by the bank of the receivers' deposits. was to make the bank and its officers officers of the court, and, therefore, directly responsible to the court for misapproprtation of the moneys deposited by the receivers under the order of court." He then said: "The adjudged cases on this point brought to the attention of the court are unsatisfactory. The statement in Rapalje on Contempts (§ 15) that 'a private corporation made the depository of the funds of the court, is an officer of the court, within the power of the court to punish by contempt process for misconduct,' is supported by a dictum of the Supreme Court of Illinois in the case of In re Western Marine & Fire Ins. Co., 38 Ill. 289, in which case it is said 'When a court makes an order appointing a particular person a depositary of the court funds, and such person, knowing of such order, accepts the deposit, he unquestionably becomes *pro hac vice* an officer of the court. The court may order him to refund the money, and if he fails to do so, *without showing some valid reason*, may proceed against him as for a contempt. The same rule would apply to a corporation, and if its officers, *having control of its funds, and having the means of payment belonging to the corporation in their hands*, should refuse to pay, they might be proceeded against as for a contempt.' It will be noticed by the foregoing that officials of a corporation delinquent as a depository are to be held as in case of contempt when they have control of its funds and have the means of payment belonging to the corporation in their hands. * * * In the present case I think that it is somewhat doubtful whether the funds deposited by the complaining receivers with the [insolvent bank] under the aforesaid order of court, were strictly court funds or could be considered as moneys paid into court. By the orders appointing them, the complainants, as joint receivers, were authorized and directed to carry on and operate the railways and property of the [railway corporation in their hands]; and such carrying on and operating contemplated and required the handling, receiving and paying out of money, the payment and collection of bills and the transaction of such financial business as would require the medium of and accommodation of banks. In the transaction of this business, moneys were not deposited as special funds to be drawn out on order of the court, but were deposited, generally, to the credit of the receivers, and to be handled and used by the bank like the deposits of its other patrons in a banking, loan and discount business. And it may be further noticed that the respondents have not the possession of the funds of the bank nor means in their hands belonging to the bank, the possession of [one of the respondents], as receiver, being that of the [Texas court appointing him]. So that if we take the law to be as broad as declared by the Supreme Court of Illinois, in the Western Marine & Fire Ins. Co. case, it is not broad enough to meet the necessities of this case; for if it is conceded that the [insolvent bank], by designation of the court and by acceptance, became an officer of the court, and that the funds deposited therein were court funds, and that, therefore, the bank is liable for misconduct in misappropriating such funds, as in cases of contempt, there is neither reason nor authority for considering that each servant or agent of the bank also became *pro hac vice* an officer of the court, and, therefore, amenable to the court, as in case of contempt for misconduct in dealing with the *bank* funds."

§ 303. President — his power and duty. — The executive officers of a bank, its president and cashier, are presumed to have authority to direct the application of any funds in the bank to its debts.[1] An official indorsement of a note payable at a bank by its president will bind the bank.[2] A president of a bank must be authorized by the board of directors, or he will not be authorized to execute a warrant of attorney to institute a suit.[3] Should a president of a bank receive stock of the bank in payment for a note made payable to the bank in its stock, he would hold the stock for the bank as its property.[4] It has been held in Vermont that the president of a bank had the right in behalf of the bank, and without special authority, to agree with the makers of a note, payable to and at the bank, upon an agent to receive money upon the note at some other place, and to forward it to the bank; and that such agency might be proved by parol.[5] A bank will be

[1] City Bank *v.* Bateman, 7 H. & J. (Md.) 104.

[2] Aiken *v.* Marine Bank, 16 Wis. 679.

[3] Bank *v.* Keim, 10 Phil. 311.

[4] Markley *v.* Rhodes, 59 Iowa, 57.

[5] National Bank *v.* Strait, 58 Vt. 448.

bound by whatever its president may do in taking a new note for matured paper, so far as it is within the apparent scope of his authority.[1] The president of a bank cannot make a valid contract to pay for obtaining depositors.[2] A president of a bank, when discounting paper for the bank, has no authority to promise the holder that he need not pay it.[3] Neither the president nor cashier of a bank organized under the laws of Kansas has the power, *virtute officii*, to sell the safe of the bank for a debt of the bank.[4] A contract made by a president of a national bank for the bank to act as agent in the purchase of bonds or stocks, as the bank has no such power, would be *ultra vires* and not binding upon the bank.[5] Notice to the president of a bank is notice to the bank.[6] A bank will be affected with notice of knowledge acquired by its president in the course of its business that money deposited by a depositor in his individual account belongs to an estate of which he may have control, for instance, as assignee for the benefit of creditors; and the money deposited by him cannot be appropriated by the bank to the payment of his notes. Payments thus made could be recovered from the bank by the assignee.[7] Where the cashier of a national bank in the usual course of business takes a note before its maturity without notice or knowledge of any defense to the note, the knowledge of the president of the bank that there was claimed to be a failure of consideration would be no notice to the bank of that fact.[8] It would be a breach of duty for a president of a bank to allow a customer of the bank to take away its securities for inspection, and he and his sureties would be liable for the results of such an act on his part without regard to the question of good faith.[9]

[1] Cake *v.* Bank, 116 Pa. St. 264.

[2] Tifft *v.* Bank, 8 Pa. Co. Ct. Rep. 606.

[3] First National Bank of Whitehall *v.* Tisdale, (1879) 84 N. Y. 655.

[4] Asher *v.* Sutton, (1884) 31 Kans. 286.

[5] Bank *v.* Hoch, 89 Pa. St. 324.

[6] Savings Bank *v.* Holt, 58 Vt. 166.

[7] Bank *v.* Peisert, 2 Pennypacker (Pa.), 278.

[8] First National Bank *v.* Sherburne, 14 Bradw. (Ill.) 566. Bank chargeable with notice of facts within the official knowledge of its president. Union Bank *v.* Wando Mining & Mfg. Co., 17 S. C. 361. Under what circumstances one who may have compromised a claim and given a release to the bank may avoid that release by reason of the falsity of a president's statement, see Gould *v.* Cayuga County National Bank, (1877) 56 How. Pr. 505. That a president of a bank has no authority to release debts, see Olney *v.* Chadsey, 7 R. I. 224.

[9] Bank *v.* Wiegand, 5 W. N. C. (Pa.) 12.

An overdraft on a bank, if made without authority, is a fraud upon the part of the drawer; if suggested, countenanced, connived at and allowed by the president of a bank, without any authority of the directors, it would be a fraud on the part of the president, and he will be held liable personally for the damages to the bank.[1] In a Kansas case it appeared that one, at the same time stockholder, director and vice-president of a savings bank, sold his stock in the bank, while it was in an embarrassed condition, to an outside party who had no funds in the bank, but, on the contrary, had an overdrawn account with the bank of several months' standing, from whom he received a check on the bank in payment for the stock for $2,100. This outside party then sold the stock to the cashier of the bank, who purchased it for the bank, but had no authority from the bank or from any one else to make such purchase. The cashier then gave to this outside party a credit for the stock of $2,100 on the books of the bank, and on the same day gave the vice-president of the bank, who had sold this stock, a credit on the books of the bank for the amount of the check drawn by the outside party, and charged the latter with a like amount. A few days afterwards the vice-president drew the amount out of the bank. The Supreme Court of that state held that the bank could maintain its action against this officer for the amount of money so withdrawn from the bank.[2] As to the duty of officers of the bank, it was held by the court that a director, having personal and private dealings with his bank, was bound to know (so far as the same affected his own personal dealings) the general condition and management of his bank, and everything of importance that occurred therein, either at the time it occurred or soon thereafter. Further, it was held that this officer, the vice-president, was bound to know when his

[1] Oakland Bank of Savings *v.* Wilcox, (1882) 60 Cal. 126. See, on the subject of personal liability of officers, Leffman *v.* Flanigan, 5 Phila. 155; Shea *v.* Mabry, 1 Lea (Tenn.), 319; Minor *v.* Mechanics' Bank, 1 Pet. 72; Eichelberger *v.* Finley, 7 Har. & J. (Md.) 387; Bank of St. Mary's *v.* Calder, 3 Strobh. (S. C.) 408; Lancaster Bank *v.* Woodward, 18 Pa. St. 362; Shear *v.* K. & K. R. R. Co., 6 Bax. (Tenn.) 278. In First National Bank *v.* Reed, 36 Mich. 263, the president of the bank was held personally liable for moneys paid out by the cashier under his directions and without security to one who was supposed to be irresponsible, with whom the president was interested in the business for which the money was obtained, these payments having been kept from the knowledge of the directors.

[2] German Savings Bank *v.* Wulfekuhler, (1877) 19 Kans. 60.

bank was in an embarrassed condition, and the condition of an account which had been overdrawn for months; and that where the cashier had given a credit to the person having such overdrawn account, for an insufficient and illegal consideration, the officer was bound to know the same within less than several days thereafter.[1]

§ 304. President's acts binding on bank — illustrations.— In an action by a receiver of an insolvent national bank against a correspondent bank to recover the amount of a deposit by the insolvent bank with this correspondent, where the evidence showed that the board of directors left it to the president, as the agent of the bank, to negotiate loans, and to make such contracts as to repayment and security as were lawful and usual, the United States Circuit Court for the southern district of New York held that the evidence was sufficient to establish the authority of the president to pledge the deposit with the correspondent bank as security for loans by it to the insolvent bank.[2] This was an action by the receiver of a national bank against the makers of a note found among its assets. The defense of the makers was that there was no consideration towards them; that it was an accommodation note made by them at the instance of the president of the bank, to be used for the purposes of the bank. The note was made payable to the order of the makers and indorsed by them. On the trial the note clerk of the bank testified to entries on the discount book indicating that the note was discounted on a certain day, and that the account of the proceeds was handed to the president of the bank, who put his signature upon it, thus making it an order on the teller for the amount therein stated; that this order was returned to the clerk, together with the president's own check for an amount sufficient to make up the face of the note, and that this amount was used to pay a former note of

[1] Ibid.

[2] Bell *v.* Hanover Nat. Bank, (1893) 57 Fed. Rep. 821. LACOMBE, Circuit Judge, said: "It is true that no express authority from the board of directors to make such an agreement is shown, but the contract is not an unusual one, and authority to make it may be established by proof of the course of business, by the usages and practice which the directors may have permitted to grow up in the business of the bank, and by the knowledge which the board of directors must be presumed to have had of the acts and doings of its subordinates in and about the affairs of the corporation. Mahoney Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 194."

the makers. As to the former note, he testified to entries on the discount book indicating that it had been discounted, and that the proceeds were deposited to the credit of the president of the bank. The bank a short time afterwards became insolvent. The United States Circuit Court of Appeals for the third circuit held that this testimony did not sufficiently show the bank to be a *bona fide* holder for value, as against the defense that the notes were procured from the makers by the president, who was also the managing officer of the bank, by fraud and without consideration. They also held that it was error to refuse to allow the makers to show that the note in suit, and the former notes which were renewed by it, were given at the solicitation of the president, who, in the actual conduct of the business of the bank, was its sole managing officer, and upon his execution of a receipt which was also offered in evidence reciting that the note was for the use of the bank, and was to be paid by it at maturity; and that he stated that he proposed to use it in the clearing house, as it would look better for the credit of the bank than numerous small notes which it held, and which small notes it would retain to protect this note of the makers, as the facts, if shown, would make a valid defense to the action. It was also held to be error to refuse the defendant's offer to show that the president was the sole managing officer of the bank, in the actual conduct of the business, and that the cashier occupied more the position of a clerk than that of actual cashier; for, if the president exercised the functions of cashier and was the sole managing officer of the bank, he had authority to borrow money for the use of the bank in the regular course of its business.[1] One intending to purchase bank-

[1] Simons *v.* Fisher, (1893) 55 Fed. Rep. 905 (BUTLER, D. J., dissenting). ACHESON, Circuit Judge, in the opinion of the majority of the court, referred to the case of Coats *v.* Donnell, 94 N. Y. 168, 176, as having features very like the case before the court. He said: "The cashier of a bank [in that case] orally agreed with a firm that if the latter would receipt certain drafts negotiated by the bank it would keep on deposit with the firm until their maturity a balance equal to the amount of the drafts, upon which the firm should have a lien; the firm to be kept informed of the condition of the bank, which the cashier stated to be embarrassed, but, with certain expected aid, able to continue business. The agreement was held to be valid, and within the power of the cashier to make, both under his general authority and by virtue of a by-law which gave him supervision of the bank, with the duty to attend to the making of loans, discounts and other active business transactions of the bank." It was said in Coats *v.* Donnell, *supra*: "The cashier

stock is entitled to rely upon a statement of its president as to the bank's condition, without inquiring further.[1]

§ 305. President's acts not binding on bank — illustrations. — The Nebraska Supreme Court has, in an action against a national bank to recover the amount of a subscription made in its name by the president of the bank to encourage and aid the erection of a paper mill, affirmed the judgment of the trial court instructing the jury to return a verdict for the bank.[2] The president of a national bank in Wyoming arranged with bankers in New York to credit his bank with $10,000, with the understanding that the bank would not draw against it, and had the New York bankers charged with the amount, and his own personal account with his bank credited with the amount, placing with the New York bankers his individual note for discount for the same amount. He then was allowed to overdraw his individual account afterwards, and then authorized the New York bankers to charge the amount of his individual note to his bank, which they did. The bank becoming insolvent, the receiver brought his action against the New York bankers for the amount. The United States Circuit Court of Appeals for the second circuit held that unless expressly authorized to do so the president of the bank could not use the funds of the bank to pay his personal obligations; and, there being no proof of such express authority, that he authorized the New York bankers to do so was not a defense to the suit.[1]

of a bank is its executive officer, and it is well settled that as an incident of his office he has authority, implied from his official designation as cashier, to borrow money for and to bind the bank for its repayment; and the assumption of such authority by the cashier will conclude the bank as against third persons, who have no notice of his want of authority in the particular transaction, and deal with him on the basis of its existence."

[1] Merrill *v.* Florida Land & Imp. Co., (1893) 60 Fed. Rep. 17.

[2] Robertson *v.* Buffalo County National Bank, (Neb. 1894) 58 N. W. Rep. 715. The court said: "The undisputed evidence in the case is that the president of the bank, without the knowledge or consent of the directory, signed the name of the bank to the subscription paper, and that the directory of the bank had never ratified this act of the president. Whether the court erred in instructing the jury to return a verdict for the bank depends, then, upon the question as to whether the bank is bound by the subscription made by its president. This bank was organized under the act of congress for the purpose of lending money, receiving deposits and for the conducting of a general banking business. The making of donations of its funds or capital to aid in the building of paper mills, canals or churches is no part of the business for which it was incorporated. The bank — that is, the corporation — by the unanimous consent of its stockholders, might, no doubt, make such donation of its capital to any enterprise or person it chose; but is the bank bound by a contract made in its name by its president, in and by which it is agreed to donate to some person or enterprise a part of its capital? A large part of the argument of counsel in this court has been directed to the doctrine of *ultra vires*, but we do not think that it is necessary to invoke that doctrine in order to reach a correct decision in this case. It seems to us that this question is one of agency. The bank is the principal and the president of the bank was its agent, and the bank, of course, was bound by the acts of its president, done within the scope of his authority. In Morawetz on Private Corporations (§ 423) it is said: 'The property and funds of a corporation belong to its stockholders, and cannot be devoted to any use which is not in accordance with their chartered purposes, except by unanimous consent. No agent of a corporation has implied authority to give away any portion of the corporate property or to create a corporate obligation gratuitously.' In Jones *v.* Morrison, 31 Minn. 140; s. c., 16 N. W. Rep. 854, it is said: 'The directors of a corporation have no authority to appropriate its funds in paying claims which the corporation is under no legal or moral obligation to pay, as to pay for past services which have been rendered and paid for at a fixed salary previously agreed on, or under a previous agreement that there should be no compensation for them.' To the same effect see Salem Bank *v.* Gloucester Bank, 17 Mass. 29; Bissell *v.* City of Kankakee, 64 Ill. 249; Minor *v.* Bank, 1 Pet. 46; Case *v.* Bank, 100 U. S. 446. In Alexander *v.* Cauldwell, 83 N. Y. 480, it is said: 'One who deals with the officers or agents of a corporation is bound to know their powers and the extent of their authority. The corporation is only bound by their acts and contracts which are within the scope of their authority.' In Rich *v.* Bank, 7 Neb. 201, it is said in the syllabus: 'No officer of a bank can bind it by a promise to pay a debt which the corporation does not owe and was not liable to pay, unless the bank authorizes or has ratified the act; but ratification is equivalent to original authority to act in the matter, and the corporations are bound in the same manner as natural persons.' We think these authorities are decisive of the case at bar. This is not a case in which the bank has received and retains the fruits of an unauthorized contract made by its agent." For an illustration of what kind of a contract made by the director of a bank, specially delegated to take charge of the matter, and who acted under the direct advice of the president of the bank, would be binding upon the bank, see Waxahachie Nat. Bank *v.* Vickery, (Tex. 1894) 26 S. W. Rep. 876.

[1] Chrystie *v.* Foster, (1894) 61 Fed. Rep. 551. WALLACE, Circuit Judge, said: "While it may be conjectured, in view of the character of [the president's] relations with the bank, that it would have permitted him at any time to overdraw his account, there is no evidence that it did not rely upon the credit [given it by the New York bankers] in its subsequent dealings [with the president], and the presumption is that the notice given by the defendants influenced the bank as they intended it should. The authorization to the defendants by [the president], in his official capacity as president of

§ 306. When a bank is not chargeable with constructive notice as to knowledge of its president.— This was an action against a bank brought by the grantor of an undivided half interest in a city lot by a full conveyance of title to one who was the owner of the other undivided half interest in the lot, at the time the president of the bank, and who had subsequently, for a valuable consideration, conveyed the whole lot to the bank for its uses, to enforce the vendor's lien upon the undivided half interest conveyed by him. It appeared that the bank knew nothing of the transaction between this vendor and its president beyond the deed of full conveyance from the grantor to the president. The United States Circuit Court of Appeals for the fifth circuit held that the bank acquiring its title by conveyance from one who held the interest in the lot under a deed reciting full payment of the purchase money, and having no actual knowledge that the purchase money was not in fact paid, was an innocent purchaser without notice, and was not chargeable with constructive notice because of the knowledge of its president. As to what did appear from the evidence that the grantor had a conversation with a director of the bank, in which he stated that he was willing to convey his half interest in the lot to the president of the bank, with the understanding that the president was to convey the whole lot to the bank, and that the president of the bank was to pay him by giving him credit upon notes then running against him in the bank, the court held that it did not amount to notice to the director that the grantor intended to retain a vendor's lien, but rather imputed a notice that no such lien was to be retained.[1]

the bank, to apply the fund in their hands belonging to the bank in payment of his note, does not protect the defendants. It is not pretended that [the president] had any express authority to apply the funds of the bank to the payment of his own note. He had no implied authority to do so. There are no presumptions in favor of such a delegation of power. He who assumes to rely upon the authority of an agent to bind his principal to the discharge of the agent's own obligation must have actual authority if contest arises. No principle of the law of agency is better settled than that no person can act as agent of another in making a contract for himself. West St. Louis Sav. Bank *v.* Shawnee Co. Bank, 95 U. S. 557; National Park Bank *v.* German-American Mut. Warehousing & Security Co., 116 N. Y. 281; s. c., 22 N. E. Rep. 567; Anderson *v.* Kissam, 35 Fed. Rep. 699. If [the president] had used his note with the defendants to procure an advance to the bank for its benefit, and not for his own, and had given them such an authorization, very different questions would be presented from those which are now in the case."

[1] First Nat. Bank of Sheffield *v.* Tompkins, (1893) 57 Fed. Rep. 20.

§ 307. Cashier — his power and duty.— The cashier of a bank is the executive officer or agent of its financial department, and, in all the duties imposed upon him by law or usage as

PARDEE, Circuit Judge, referred in support of the court's ruling to certain cases in these words: "In the case of Whelan *v.* McCreary, 64 Ala. 319, Mr. Chief Justice BRICKELL, speaking for the court, declared the law of Alabama as follows: 'Whoever gives value, or enters into transactions by which his position is materially changed, and from which change loss must ensue, on the faith that the vendor of real estate, or person with whom he deals, has, as the title papers exhibit, a clear legal title, will be protected against outstanding and latent equities, of which he has no notice. A mortgagor taking a security for a contemporaneous loan or advance falls within the rule and is entitled to protection. Boyd *v.* Beck, 29 Ala. 713; Wells *v.* Morrow, 38 Ala. 125. The only notice, actual or constructive, of Mrs. Whelan's equity, which is attributed to the insurance company, is imputed, because notice, it is insisted, is traced to Williams, one of its directors, active and instrumental in making the loan to Cunningham and McCreary, and taking the mortgage. Whatever facts may have been known to Williams which ought to have excited inquiry on his part, came to his knowledge while he was acting as the agent of Cunningham, in a transaction in which the insurance company had no interest. The rule is settled in this state that a corporation will not be affected by notice which one of its directors or other officers may have received when not acting for the corporation, but in the transaction of his own private affairs, and under such circumstances that its communication to other officers of the company is not to be expected. Terrell *v.* Bank, 12 Ala. 502. If the facts were stronger for the imputation of notice to Williams than are found in the record, notice should not be imputed to the insurance company.' The case of Barnes *v.* Gas Light Co., 27 N. J. Eq. 33-37, involved a question in regard to notice very similar to the case in hand, and the chancellor held as follows: 'That the defendants are *bona fide* purchasers for valuable consideration is not denied. Their title is not impugned, except on the ground of notice, and the claim to relief is based on the allegation that at the time when the conveyance was made by Mr. Potts to them he was their president, and this fact is relied upon as of itself sufficient to establish notice to them of all the facts which the bill charges were within his knowledge. The general proposition is undoubtedly true that notice of facts to an agent is constructive notice thereof to the principal himself, where it arises from or is at the time connected with the subject-matter of his agency. The rule is based on the presumption that the agent has communicated such facts to the principal. Story Ag. § 140. On principles of public policy the knowledge of the agent is imputed to the principal. But the rule does not apply to a transaction such as that under consideration, for, in such a transaction, the officer, in making the sale and conveyance, stands as a stranger to the company. Stratton *v.* Allen, 16 N. J. Eq. 229. His interest is opposed to theirs, and the presumption is not that he will communicate his knowledge of any secret impurity of the title to the corporation, but that he will conceal it. Where an officer of a corporation is thus dealing with them in his own

such cashier, he acts for the bank and speaks for it.[1] A cashier, in the absence of all positive and known restrictions, possesses the incidental authority, and it is his duty to apply the negotiable funds of a bank as well as the moneyed capital to the discharge

interest, opposed to theirs, he must be held not to represent them in the transaction, so as to charge them with the knowledge he may possess, but which he has not communicated to them, and which they do not otherwise possess, of facts derogatory to the title he conveys,' citing in support of the same Bank *v.* Cunningham, 24 Pick. 270; Kennedy *v.* Green, 3 Mylne & K. 699; In re European Bank, L. R., 5 Ch. App. 358; In re Marseilles Extension Railway Co., L. R., 7 Ch. App. 161; Winchester *v.* Railroad Co., 4 Md. 231. In Commercial Bank of Danville *v.* Burgwyn, (1892) 110 N. C. 267, certain promissory notes were indorsed to a corporation and by its president indorsed for value to a bank some months before they were due. The president of the corporation was a director of the bank and in the matter of discounting these notes had spoken to the president of the bank, who ordered them discounted, but this director, the president of the corporation, took no action in the matter of the discounting of the note. In this action by the bank upon the note it was claimed that the note was subject to a certain equity or set-off of the maker, on the ground that the president of the corporation knew it had notice of the impurity of the note, and, being a director of the bank, notice to him was notice to the bank. The Supreme Court of North Carolina said: 'That conceding * * * that if the director of the bank had such notice at the time of the discounting of all of the notes, it is well established that the plaintiff [the bank] cannot be affected therewith unless [he] was acting in his official capacity for the plaintiff in the said discounting transactions. The foundation principle upon which rests the doctrine that a party, whether an individual or a corporation, is chargeable with notice imparted to his agents in the line of their duty, is that agents are presumed to communicate all such information to their principals because it is their duty so to do. The principal is conclusively presumed to know whatever his agent knows, if the latter knows it as agent. Of course no such presumption can exist where the agent is dealing with the corporation in the particular transaction in his own behalf.' In such transactions the attitude of the agent is one of hostility to the principal. He is dealing at arm's length, and it would be absurd to suppose that he would communicate to the principal any facts within his private knowledge affecting the subject of his dealing unless it would be his duty to do so, if he were wholly unconnected with the principal. As was said by the court in Wickersham *v.* Chicago Zinc Co., 18 Kans. 481: 'Neither the acts nor knowledge of an officer of a corporation will bind it in a matter in which the officer acts for himself and deals with the corporation as if he had no official relations with it,' or, as was said in Barnes *v.* Trenton Gas Light Co., 27 N. J. Eq. 33: 'His interest is opposed to that of the corporation, and the presumption is not that he will

[1] Ellicott *v.* Barnes, (1884) 31 Kans. 172; Lane *v.* Bank of West Tennessee, 9 Heisk. 419; Maxwell *v.* Planters' Bank, 10 Humph. 507; United States *v.* City Bank of Columbus, 21 How. 364.

of the bank's debts and obligations.[1] The power of a cashier to purchase for the bank is not implied from his office as cashier.[2] A bank will be bound by the agreement of its cashier to extend paper.[3] A statement by its cashier, upon inquiry of one known by him to be a surety on a note due the bank, that the note had been paid, with the intention that the surety should rely upon the statement, and the surety does so, and in consequence change his position by giving up securities or indorsing other notes for the same principal or the like, will estop a bank from denying that the note was paid.[4] The cashier of a bank, without special authority, cannot bind it by an official indorsement of his personal note. In an action on such a note the onus would be upon the payee to show the cashier's authority.[5] A bank has been held

communicate his knowledge of any secret infirmity of the title to the corporation, but that he will conceal it.' This doctrine has been applied to the case of a director procuring the discount of a note for his own benefit, having knowledge that it is founded upon an illegal consideration (Bank *v.* Christopher, 40 N. J. L. 435), or that it was made for his accommodation (Bank *v.* Cunningham, 24 Pick. 270), or that it was obtained upon a false pretense of having it discounted for the maker (Washington *v.* Lewis, 22 Pick. 24), or that it was affected in his hands with certain conditions (Louisiana State Bank *v.* Senecal, 13 La. 525), or with a claim of recoupment of which the bank had no notice (Loomis *v.* Bank, 1 Disney, 285), or with other equities. Savings Bank *v.* Hamlin, 125 Mass. 506. To the same effect are Corcoran *v.* Snow Cattle Co., 151 Mass. 74; Innerarity *v.* Bank, 139 Mass. 332; Stevenson *v.* Bay City, 26 Mich. 44; Frost *v.* Belmont, 6 Allen, 163, and other cases. In the foregoing decisions the director was not acting in his official character in the particular transaction, but had he been so acting, the bank by a great preponderance of authority would have been affected by his knowledge."

[1] Maxwell *v.* Planters' Bank, (1850) 10 Humph. (Tenn.) 507.

[2] Lionberger *v.* Mayer, (1882) 12 Mo. App. 575. As to the acts of a cashier, within the sphere of his duties, being the acts of a bank, see Burnham *v.* Webster, 19 Me. 232; Medomak Bank *v.* Curtis, 24 Me. 36; Warren *v.* Gilman, 17 Me. 360; Farrar *v.* Gilman, 19 Me. 440; Badger *v.* Bank of Cumberland, 26 Me. 428; National Bank of Metropolis *v.* Williams, 46 Mo. 17. As to the authority of cashiers of banks, see Caldwell *v.* National Mohawk Valley Bank, 64 Barb. 333; Chemical National Bank *v.* Kohner, 8 Daly, 530. As to powers habitually exercised by a cashier with the knowledge and acquiescence of the bank, see Merchants' Bank *v.* State Bank, 10 Wall. 604.

[3] Wakefield Bank *v.* Truesdell, 55 Barb. 602.

[4] Cocheco National Bank *v.* Haskell, 51 N. H. 116.

[5] West St. Louis Sav. Bank *v.* Shawnee County Bank, (1874) 3 Dill. 403; affirmed in 95 U. S. 557. In Houghton *v.* First National Bank of Elkhorn, 26 Wis. 663, the bank was held to be bound by its cashier's indorsement of his name followed by the abbreviation "Cas." on the negotiable note of another, though not done at the bank, or for its benefit, and by his statement to a purchaser that such statement was all right. As to pay-

not responsible to the real owner for money paid out with his consent to the administrator of the apparent owner, the one who had deposited it, even though his consent had been given upon the advice of the bank's cashier.[1] A bank will be bound by representations made by its cashier in the ordinary course of business as to the payment of a note in the bank, upon the faith of which the maker of the note may have acted.[2] It may be shown by parol that a check signed by one who is the cashier of a bank in his own name only is the check of the bank.[3] The assignee of a bank, it has been held, could not recover the securities delivered by a cashier as collateral for money borrowed on the bank's note from the lender.[4] Receiving offers for purchase of securities held by a bank, and a statement whether or not the bank owns securities in its possession, are within the scope of the general authority of its cashier.[5] The act of a cashier in certifying a check given as collateral security for the delivery of oil, "good when properly indorsed," has been held not to have rendered the bank liable, as his act was outside his proper powers and duties.[6] Evidence of the custom of bankers where a bank is located to borrow money on time is competent in an action against bankers upon a note given by their cashier for money borrowed which he may have appropriated to his own use, as tending to show that the act was within the scope of the ordinary and customary business of the bankers.[7] A bank is not exonerated from its liability for money borrowed by the fact that its cashier may have given his own note for money borrowed by him for the bank.[8] The provisions in the charters of certain banks in Georgia requiring all contracts whatever to be signed by the president and countersigned by the cashier in order to bind the banks were held by the Supreme Court of that state not to apply to such dealings and transactions as are usually and necessarily performed by the

ment of overdrafts by a cashier being a violation of his duty, see Bank *v.* Calder, 3 Strob. (S. C.) 403.

[1] McDermott *v.* Bank, 100 Pa. St. 287.

[2] Manufacturers' Bank *v.* Scofield, 39 Vt. 590.

[3] Mechanics' Bank *v.* Bank of Columbia, 5 Wheat. 326.

[4] Creswell *v.* Lanahan, 101 U. S. 347. What is necessary to show a cashier's authority to borrow money for the bank. Ringling *v.* Kohn, (1878) 6 Mo. App. 333; Donnell *v.* Lewis Co. Savings Bank, (1883) 80 Mo. 165.

[5] National Bank of Xenia *v.* Stewart, 114 U. S. 224.

[6] Dorsey *v.* Abrams, 85 Pa. St. 299.

[7] Crain *v.* National Bank, 114 Ill. 516.

[8] City Bank of New Haven *v.* Perkins, (1859) 4 Bosw. 420.

cashier of a bank, such, for instance, as the drawing or indorsing by a cashier in connection with bills of exchange, checks and drafts.[1] A cashier may, *ex-officio*, indorse a note the property of the bank so as to authorize a demand and notice to the indorser.[2] In the course of his ordinary duties, the cashier of a bank, *virtute officii*, may transfer the paper securities of the bank in payment of the debts of the bank. The inducement for such indorsement of the papers need not appear; in the absence of proof to the contrary the presumption would be in favor of the propriety of the transfer. But such an inference would not be conclusive. A party interested would be authorized to controvert the fairness of the transfer by showing that it was not made in the regular course of business, but in prejudice of the rights and interests of the bank, and thus defeat the transfer.[3] The exercise by the cashier of a bank of his power to pledge the negotiable securities belonging to the bank is *prima facie* evidence that he had the power.[4] Without authority from his bank, evidenced by a resolution of the board of directors, usage in like cases, or in some other way, a cashier cannot transfer non-negotiable paper.[5] But he has authority growing out of his peculiar relation to the bank and his duties resulting therefrom to transfer negotiable paper belonging to the bank for a legitimate purpose.[6] A cashier can invest no clerk of the bank with any more of his power than is necessary to enable the clerk to carry on the usual and ordinary business of the bank. A clerk acting as cashier in the absence of that officer has no authority, unless conferred upon him by the directors, to transfer notes or

[1] Merchants' Bank *v.* Central Bank, 1 Ga. 418; Cary, Assignee, *v.* McDougald, 7 Ga. 84.

[2] Hartford Bank *v.* Barry, (1821) 17 Mass. 94; Folger *v.* Chase, (1836) 18 Pick. (Mass.) 63.

[3] Everett *v.* United States, 6 Port. (Ala.) 166. As to the power of a cashier of a bank to transfer its notes and assets in payment of the bank's indebtedness, see Kimball *v.* Cleveland, 4 Mich. 606; Peninsular Bank *v.* Hanmer, 14 Mich. 208. Whether the power to apply the assets in this way includes the power to guarantee their collection or invalidity was questioned in the last case. As to the powers of a cashier in discharging and transferring securities, etc., of the bank, see State *v.* Commercial Bank of Manchester, 6 Smedes & Marsh. (Miss.) 218; Harper *v.* Calhoun, 7 How. (Miss.) 203; Crocket *v.* Young, 1 Smedes & Marsh. (Miss.) 241.

[4] Mercantile Bank *v.* McCarthy, (1879) 7 Mo. App. 318; Bank of State *v.* Wheeler, 21 Ind. 90.

[5] Barrick *v.* Austin, (1855) 21 Barb. 241.

[6] Bank of New York *v.* Bank of Ohio, (1864) 29 N. Y. 619.

securities of the bank.[1] A clerk thus temporarily acting for the cashier may transmit notes owned by the bank or held for collection to the bank's agents for that purpose, and to vest in the collecting agents such title as is necessary and proper to accomplish that object. But he has no power to transfer any other or higher title thereto, and the agents of the bank will not, as against the bank, acquire any lien on the notes for any balance due from the bank.[2] As its executive officer, a cashier of a bank has authority to take such measures for the security and eventual collection of a debt of the bank as he deems proper, and to act in reference to the collection or compromise of the debt according to the general usage, practice and course of business.[3] A cashier of a bank has power, *prima facie*, to indorse for collection notes discounted and notes deposited with the bank to be collected or deposited as collateral security.[4] But he cannot indorse, without special authority, a note made payable to a bank and discounted by another person.[5] A cashier may bind a bank for costs incurred in the collection of a note which he has indorsed for collection.[6] That it was the usage of a bank, or that the bank, through its directors, had adopted his act, if proven, would be a sufficient authority for the satisfaction of judgments in favor of the bank by its cashier, although he may have no authority under seal or in writing to satisfy such judgments.[7] A cashier has no power to accept bills of exchange on behalf of the bank for the accommodation merely of the drawers.[8] A bank will be bound by the official signature of its cashier to a negotiable note.[9] A bank may be held liable for a loan obtained on its account for which the personal note of its cashier may be given on a count for money had and received.[10] Unless the power to accept has been conferred upon him by the corporation, a bank will not be bound

[1] Potter *v.* Merchants' Bank, (1864) 28 N. Y. 641.

[2] Ibid.

[3] Bridenbecker *v.* Lowell, (1860) 32 Barb. 9.

[4] Elliot *v.* Abbot, 12 N. H. 549; Corser *v.* Paul, 41 N. H. 24, 26.

[5] Cross *v.* Rowe, 22 N. H. 77.

[6] Eastman *v.* Coos Bank, 1 N. H. 23, 25. As to the power of a cashier of a bank to collect a note due it and to adopt such measures as may be necessary to that end, see Young *v.* Hudson, (1889) 99 Mo. 102.

[7] Bancroft *v.* Wilmington Conf. Academy, 5 Houst. (Del.) 577.

[8] Farmers', etc., Bank *v.* Troy City Bank, 1 Dougl. (Mich.) 457.

[9] Rockwell *v.* Elkhorn Bank, 13 Wis. 653; Ballston Spa Bank *v.* Marine Bank, 16 Wis. 120.

[10] Chemical Nat. Bank of Chicago *v.* City Bank of Portage, (Ill. 1895) 40 N. E. Rep. 328.

by its cashier's acceptance of a bill of exchange in his official capacity.[1] A cashier of a bank has no power to transfer judgments in favor of the bank, or to dispose of its property.[2] Neither has he power to discount a note; but if he discount a note his act will be valid, if afterwards ratified by the bank.[3] By his general power to certify checks, a cashier of a bank is not authorized to certify a post-dated check.[4] The general powers of its cashier do not include authority to bind a bank to indemnify an officer for levying on property.[5] There is no implied power in a cashier of a bank to pledge its assets for payment of an antecedent debt.[6] A cashier of a bank as such has no power to accept a note signed by two parties only, in payment and discharge of a note upon which another party was also bound with the two, so as to release the third party from his indebtedness to the bank.[7] Neither can he, *virtute officii*, release a surety upon a note, even though the bank holds other security to which it might resort, nor make collateral contracts or agreements of any kind.[8] It is not within the ordinary scope of the duties of a cashier of a bank to discharge a surety on a debt due the bank.[9] A cashier of a bank cannot, by reason of the general authority he may have to certify checks, certify his own checks or issue certificates of deposit to himself.[10] It would be beyond the scope and power of the cashier of a private bank (himself a partner) to enter credits upon the bank book of a depositor without any check, bill or note being presented for discount. Should he enter the credits on the books of the bank and the depositor be permitted to draw the money, the bank would be estopped from setting up the want of authority in the cashier; but it would be otherwise as to credits not entered on the books of the bank, though duly entered on the

[1] Pendleton *v.* Bank of Kentucky, (1824) 1 Mon. (Ky.) 179.

[2] Holt *v.* Bacon, 3 Cushman, (Miss.) 567.

[3] Planters' Bank *v.* Sharpe, 4 Smedes & Marsh. (Miss.) 75.

[4] Clarke National Bank *v.* Bank of Albion, (1868) 52 Barb. 592.

[5] Watson *v.* Bennett, (1851) 12 Barb. 196.

[6] State of Tennessee *v.* Davis, (Sup. Ct. N. Y. Spl. Term, 1874) 50 How. Pr. 447.

[7] Ecker *v.* First National Bank of New Windsor, (1882) 59 Md. 291, 303.

[8] Ibid.

[9] Daviess Co. Savings Association *v.* Sailor, (1876) 63 Mo. 24. That a cashier has no power to discharge a surety on bank paper, see Cocheco National Bank *v.* Haskell, 51 N. H. 116. Release of surety by cashier. Merchants' Bank *v.* Rudolf, 5 Neb. 540.

[10] Lee *v.* Smith, (1884) 84 Mo. 304.

depositor's pass book.[1] The cashier of a national bank which holds the paper of a firm of which he was a member, it has been held, could not waive liability on an accommodation note procured by him to be substituted for the indebtedness of his firm.[2] A cashier of a bank cannot bind it as an accommodation indorser on his individual note.[3] Neither can he bind the bank by assurances that would release parties from their liability on a note held by the bank.[4] The act of an assistant cashier of a bank, prohibited by the bank to certify checks, in accepting a post-dated check without any usage to justify it, would be void, even as toward a *bona fide* holder.[5] A director in a savings institution of West Virginia, by collusion with other directors and the co-operation of the cashier, when he knew the institution was insolvent, withdrew a deposit of a large sum of money which he had had for some length of time in the institution at interest. The money was not paid to the whole amount, but the cashier paid him in bills and notes which had been discounted by the bank and belonged to it. The bank having made an assignment to one for the benefit of its creditors, he brought his action against the director to recover the amount which he had received on the ground of the fraud and other wrongdoing by which it was accomplished. The Court of Appeals of West Virginia held that this assignee or trustee was entitled to recover in proper action the amount of deposits which this director had withdrawn under the circumstances disclosed in the case.[6] In an action by a Nebraska

[1] Williams *v.* Dorrier, 135 Pa. St. 445.

[2] Allen *v.* Bank, 127 Pa. St. 51.

[3] West St. Louis Savings Bank *v.* Shawnee County Bank, 95 U. S. 557.

[4] Bank of Metropolis *v.* Jones, 8 Pet. 12.

[5] Pope *v.* Bank of Albion, (1874) 57 N. Y. 126.

[6] Lamb *v.* Cecil, (1884) 25 W. Va. 288. It was necessary in determining this question for the court to discuss the question of the power and authority of a cashier to dispose of the discounted bills and notes, the property of the bank. Upon that question it was said by JOHNSON, President, speaking for the court: "It is not pretended that he had any such authority from the board of directors. The whole record is against any such presumption as this. Did he then, *virtute officii*, have the right to dispose of the discounted bills and notes of the bank? There is nothing in the charter of the institution conferring that right upon him. The management is there conferred upon a board of directors. The Court of Appeals of New York, in Hoyt *v.* Thompson, 1 Seld. 320, held that where the management of the affairs of a corporation is intrusted by its charter to a board of directors, the president and cashier, unless specially authorized by the charter, have no power to assign the choses in action of the corporation to its creditors as security for the payment of a precedent debt of the corporation without authority from the board of directors. An assignment so made is not merely voidable, but is absolutely void. RUGGLES, Ch. J., in delivering the opinion of the court, said: But the power and duties of the president and cashier are not prescribed by the charter; no power is conferred upon them to mortgage, assign or dispose of the property of the corporation. This is a part of the management of the business of the company which is confined expressly to the directors, but not to the president and cashier. In no case has it been held that these officers are authorized to do an act like that in question without the assent and authority of the directors. To the same effect is Spear *v.* Ladd, 11 Mass. 94, and Bank *v.* Pepoon, 11 Mass. 288. Indeed, in the first of these cases it was gravely considered whether the board of directors could confer such powers on the president and cashier; and, in the second, whether they could confer it on any attorney. In the last-named case, PARKER, Ch. J. (p. 292), said: 'This power puts the whole property of the bank under the control of the directors, and without doubt the power may be abused. But the stockholders should provide against this evil in the choice of directors. Having this power, there is no reason why it should not be exercised by one of the body with the consent of the rest, expressed by their vote. We are satisfied, therefore, that the directors might by their vote or power of attorney authorize the president or any other officer of the bank to assign over the promissory notes payable to the company.' In Fleckner *v.* U. S. Bank, 8 Wheat. 338, it was held that the authority of the cashier to assign a note of the bank need not be under the corporate seal, but that a resolution passed by the directors was sufficient authority for the cashier. I can find no authority which holds that the cashier, without authority from the directors, can dispose of the discounted bills and notes of the bank. It would be a dangerous power, indeed, to repose in an officer of the bank. It would put a large part of the property of the bank under the absolute control of the cashier or other officer exercising such power; and he might, for his own use, dispose of such property and pass good title thereto."

bank upon a note the maker, as a defense, claimed payment of the balance due on the note, in that he had sold to the bank through its cashier certain shares of stock in an insurance company, the cashier promising at the time that he would credit them on the note when it should be returned from another city, where it then was. The Supreme Court of Nebraska held that the cashier, by virtue of his office, had not the power to accept the stock of the insurance company in payment of the debt due the bank, but that power, if it existed, was lodged in the directory, and, as it had not expressly authorized the cashier thereto, he exceeded his power in agreeing to accept, on behalf of his principal, the insurance company stock in payment of the debt due the bank, and that the bank was not bound thereby.[1]

[1] Bank of Commerce *v.* Hart, (1893) 37 Neb. 197. RYAN, C., speaking for the court, as leading to and supporting

§ 308. Cashier's liability for his acts. — A cashier applying to his use securities of a bank will be liable on his bond for the full amount.[1] And a misapplication by such officer of funds delivered to him out of business hours and remote from the banking house, will be a violation of the condition of his official

their conclusion, made reference to leading authorities, as follows: "In Sandy River Bank *v.* Merchants & Mechanics' Bank, 1 Biss. 146, the facts were: The cashier of the Mechanics' Bank settled an account of twenty-two thousand dollars with the cashier of the Sandy River Bank, by paying ten thousand dollars cash and giving twelve thousand dollars private paper, which the cashier of the Sandy River Bank accepted in payment, and gave a receipt in full. The Sandy River Bank brought its action against the Merchants and Mechanics' Bank on the account. The latter pleaded payment by the contract with the cashier. The question in the case was whether the cashier had authority to receive in payment anything but money. In the course of the opinion delivered, the judge said: 'A cashier of a bank is ordinarily the executive of the bank. He is the agent through whom third persons transact their business with the bank. The bank generally holds him out to the world as having authority to act according to the general usage, practice and course of business, and all acts done by him within the scope of such usages, practice and course of business, bind the bank as to third persons who transact business with him on the faith of his official character; and perhaps it may be presumed without proof, and merely from his office, that he is authorized to receipt and discharge debts, and deliver up securities on payment or discharge of the debt for which they are held. * * * But still this authority is a *limited authority*, and when a party claims a discharge from a debt due the bank, not by payment, but by giving other or different notes, bills or securities, which the cashier has agreed to take and release the debt, his authority, like that of any other agent, must be shown by proof. As a general rule, a jury have not a right to infer that the cashier of a bank, as such, has the authority to compromise and discharge debts without payment or by taking other securities, but the authority from the bank must be shown expressly or by necessary implication, or it must * * * be established by the particular usage or practice or mode of doing business of the bank, or it must be ratified or acquiesced in by the bank in order to be binding.' In United States *v.* City Bank of Columbus, 21 How. 356, the facts were: The cashier of the Columbus Bank gave to one of its directors, Miner, a letter to the secretary of the treasury of the United States, to the effect that Miner had authority to contract in behalf of the bank for the transfer of money for the government. Relying upon this letter, the secretary of the treasury made a contract with Miner for him to transfer one hundred thousand dollars of the government's money from New York to New Orleans. Miner received the money, but never delivered it. The United States brought suit against the Columbus bank to recover the money. The Supreme Court of the United States decided that the action could not be successfully maintained, as the cashier

[1] Pendleton *v.* Bank of Kentucky, (1824) 1 Mon. 179.

bond.[1] A cashier of a banking corporation, having authority to loan the money of the bank, with or without security, has been held in California liable for losses arising from loans without security not entered in the books of the bank nor reported to the board of

of the Columbus bank had no authority to make such a contract, and there was no proof that the board of directors had authorized it. In the course of the opinion Justice SWAYNE said: 'The court defines the cashier of a bank to be an executive officer by whom its debts are received and paid, and its securities taken and transferred, and that his acts, to be binding upon a bank, must be done within the ordinary course of his duties. * * * The term 'ordinary business,' with direct reference to the duties of cashiers of banks, occurs frequently in * * * reports of the decisions of our state courts, and in no one of these has it been judicially allowed to comprehend a contract made by a cashier, without an express delegation of power from a board of directors to do so, which involves the payment of money, unless it be such as has been loaned in the usual and customary way. Nor has it ever been decided that a cashier could purchase or sell the property or create an agency of any kind for a bank which he had not been authorized to make by those to whom has been confided the power to manage its business, both ordinary and extraordinary.' The court then addressed itself to the case at bar, and said: The power of this bank to purchase stock in an insurance company, if it exists at all, is an extraordinary power and one not confided to the cashier, but belonging to the directory. In The Bank of Healdsburg *v.* Bailhache, 65 Cal. 329, it is said that the power to make a settlement of defalcation to a bank, and accept a deed of real estate in satisfaction and release, is the function of the board of directors and not of any individual director or officer. It has also been decided that, in the absence of special authority, the cashier of a bank could not release the surety from a note owned by the bank. Merchants' Bank *v.* Rudolf, 5 Neb. 527; Cocheco National Bank *v.* Haskell, 51 N. H. 116. That in the absence of special authority or established usage the cashier has no power to compromise claims due his bank. Chemical National Bank *v.* Kohner, 8 Daly, 530. That he had no authority to bind his bank by issuing a certificate of deposit to himself. Lee *v.* Smith, 84 Mo. 304. Nor bind the bank by an official indorsement of his own note. West St. Louis Savings Bank *v.* Shawnee County Bank, 95 U. S. 557. The cashier of the [plaintiff bank], then, as the executive officer of the bank, was clothed with authority to collect all debts due the bank, but this means collections in money. If a cashier may discharge the debts due his bank by exchanging the evidences of them for stocks of an insurance company or a gas company, then he can, under the name and charter of the bank, conduct an entirely different business, and use the funds of his stockholders for a purpose for which they were never subscribed, and in violation of the law of the bank's creation. The purposes for which [this bank] was organized, as expressed in its articles of incorporation, were to receive deposits of money and pay the same out on proper vouchers; to loan money on personal security; to issue

[1] Ibid.

trustees, but treated in his reports to the board as cash on hand.[1] The obligors upon a bond of the cashier of a bank under a condition for him "safely and securely to keep all moneys deposited, and to refund and pay over the same when properly required," will not be held liable for money violently robbed from him while in the discharge of his duty.[2] A bond of a cashier of a bank framed to cover past as well as future delinquencies will be invalid against a surety, if his name was procured at the desire of the directors where they have knowledge that past defalcations exist of which the surety may be ignorant and withhold the knowledge from him when they have a suitable opportunity to communicate it.[3] A cashier of a bank employed to sell certain shares of its stock at a fixed price, but before he had completed the sale, the bank was enjoined and proved insolvent, has been held not to be responsible for the supposed value of the stock, no negligence on his part in forwarding the sale being shown.[4] Where a bank brings an action against its cashier for a wrongful appropriation of moneys, it would be no defense that at the time of the appropriation he was the owner of four-fifths of the stock of the bank and had since that time sold all of his stock to other parties who were now the officers and managing authority of the bank.[5] The condition of

drafts or letters of credit; to buy and sell securities of every kind, and do a general banking business. Had this charter expressly provided that the corporation might invest its funds in stocks of insurance companies and deal generally in stocks of other corporations, such a provision would have been contrary to the laws of the state and void. But there is no provision in the bank's charter which by any reasonable construction can be construed into an authority to purchase and hold the stocks of any other corporation. True, it says 'to purchase securities of every kind,' but certificates of stock are not securities within the meaning of this provision, nor such as the word imports in commercial or banking phraseology. 'Securities,' as here used, means notes, bills, evidences of debt, promises to pay money." As to the authority of a savings bank's treasurer, having power to collect its debts, under orders of the board of investment, to execute a power of sale under a mortgage to the bank, by conveying to a purchaser, see North Brookfield Sav. Bank *v.* Flanders, (Mass. 1894) 37 N. E. Rep. 307. See, also, Bank *v.* Keavy, 128 Mass. 298; Holden *v.* Upton, 134 Mass. 177, 179; Trustees of Smith Charities *v.* Connolly, 157 Mass. 272; s. c., 31 N. E. Rep. 1058.

[1] San Joaquin Valley Bank *v.* Bours, (1884), 65 Cal. 247.

[2] Bank of Huntsville *v.* Hill, 1 Stew. (Ala.) 201.

[3] Franklin Bank *v.* Cooper, 36 Me. 179; Franklin Bank *v.* Stevens, 39 Me. 532; Franklin Bank *v.* Cooper, 39 Me. 542.

[4] Washburn *v.* Blake, 47 Me. 316.

[5] First National Bank *v.* Drake, (1883) 29 Kans. 311.

the bond of the cashier of a state bank as required by the statute of Indiana is that he "will honestly and faithfully discharge [his] duties as such [officer] * * * during [his] continuance in office." This was an action against the cashier of a bank and his sureties upon his official bond, and his acts complained of were that he converted different amounts of the large sums of money coming into his hands to his own use, as alleged in one paragraph of the complaint. In another it was alleged that pursuant to the by-laws of the bank it had organized an "exchange committee, composed of its president, cashier and a designated director; that the by-laws further provided that the cashier should not make loans in excess of five hundred dollars without the approval of such committee or one member besides himself." It was further alleged that as cashier that officer, in violation of his trust and the said by-laws, loaned and otherwise disposed of large sums of money belonging to the bank, which were wholly lost. Various other breaches of the bond were charged in allowing overdrafts of customers, making loans in violation of his trust and the rules and regulations of the bank; also, that by a conspiracy with two others, large sums of money were withdrawn from the vaults and invested in "options" and "bucket-shop deals" so-called; with further allegations of the entire loss of such moneys and the concealment on his part of these transactions from the other officers of the bank. The sureties, in their answer, admitted these allegations, but alleged that, in violation of its duty and the requirement of the by-laws in force when the bond sued on was executed, the bank failed to organize an "exchange committee," and because of such failure the duties of the cashier were delayed, and, as the result, the various breaches of duty and losses complained of ensued, and hence they were not liable. Berkshire, J., for the Supreme Court, in the opinion, said of this answer: "The basal rock upon which these paragraphs of the answer rest is the allegation that there was no exchange committee organized, as required by the by-laws;" and afterwards: "But the answers themselves disclose the existence of the 'exchange committee' provided for in the by-laws. They show that this committee was to be composed of the cashier, president and a designated director. The committee was composed of three members; the by-laws named two of them, or a majority; the failure to name a director for that committee did not deprive the committee of its powers;

the two had power to act. Besides, the by-laws provided that the cashier was at liberty to take any legitimate action in disposing of the funds of the bank with the approval of its president; hence, the approval of the chief officer would have been the cashier's justification as to any such transaction. But if it were conceded that the bank had entirely failed to provide for an 'exchange committee,' and in the absence of such committee that the cashier had exclusive and complete authority to transact any and all of the business of the bank, this would not relieve his sureties from liability because of his fraudulent conduct in connection with [co-conspirators], whereby large sums of money belonging to the bank were invested in illegitimate transactions. Under no circumstances was the cashier authorized to dispose of the funds of the bank for such purposes. With or without the approval of an 'exchange committee,' such as provided for, this was a clear violation of duty and rendered his sureties liable." The court further held that an agreement by the board of directors, after the execution of the cashier's bond, enlarging his duties, and increasing his salary, but not changing the character of his duties, or his relation to the bank as cashier, was no defense to this action against the sureties for the cashier's violation of duty.[1]

§ 309. Knowledge of its cashier not imputable to bank — illustration.— In an action by the makers of a note against a bank cashier to have the note surrendered for cancellation, it being alleged that there was fraud or misrepresentation on the part of one who was not only cashier of the bank which had discounted the note for the corporation, and also secretary and treasurer of this outside corporation, concerning which the representations alleged to be fraudulent were made, it was attempted to charge the bank with his knowledge. The Supreme Court of Missouri, in affirming the dismissal of this bill, stated "that," as shown by the evidence, "in the negotiation for the sale and further delivery of the stock [the cashier of the bank] represented, and only represented, the company; that the plaintiff relied wholly upon him, as the secretary and treasurer of the company, for the delivery of the stock for which he had contracted. To that transaction the bank was an entire stranger, and in it its cashier neither represented, nor undertook to represent, the

[1] Wallace *v.* Exchange Bank of Spencer, (1890) 126 Ind. 265.

bank."[1] Notice to a cashier that stock pledged to a bank was trust stock has been held to be notice to the bank of that fact.[2] It has been held in Vermont that notice to the attorney of a bank or to the cashier, while acting in the matter of attaching land for the benefit of the bank, of an equitable right in a third person — as, by a defective deed or record — was notice to the bank.[3]

§ 310. Rules as to ratification of a cashier's act by the bank.—In a case before the Supreme Court of Iowa it appeared

[1] Benton *v.* German-American National Bank, (Mo. 1894) 26 S. W. Rep. 975; citing 1 Mor. Priv. Corp. § 540c; Bank *v.* Loyhed, 28 Minn. 396; s. c., 10 N. W. Rep. 421; DeKay *v.* Water Co., 38 N. J. Eq. 158; Wilson *v.* Bank, (Pa.) 7 Atl. Rep. 145. See, also, Bank *v.* Christopher, 40 N. J. L. 435; Inerarity *v.* Bank, 139 Mass. 332; s. c., 1 N. E. Rep. 282; Barnes *v.* Gas Light Co., 27 N. J. Eq. 33; Bank *v.* Neass, 5 Den. 329; In re European Bank, 5 Ch. App. 358; Bank *v.* Savery, 82 N. Y. 291; Fisher *v.* Murdock, 13 Hun, 485; Oates *v.* National Bank, 100 U. S. 239, 245; Louisiana State Bank *v.* Senecal, 13 La. 527; Branch Bank at Huntsville *v.* Steele, 10 Ala. 915. The Missouri court said: "Whatever may have been his knowledge of the condition of the company's stock account, or of its affairs generally, that knowledge cannot be imputed to the bank when, subsequently, he came to procure for that company a discount of paper acquired in his negotiations for the company which he represented. It seems to be well-settled law in this state that knowledge which comes to an officer of a corporation through his private transactions, and beyond the range of his official duties, is not notice to the corporation. State Savings Assn. *v.* Nixon-Jones Printing Co., 25 Mo. App. 643; Bank *v.* Schaumburg, 38 Mo. 228; Manhattan Brass Co. *v.* Webster Glass & Queensware Co., 37 Mo. App. 145; Hyde *v.* Larkin, 35 Mo. App. 366; Johnston *v.* Shortridge, 93 Mo. 227; s. c., 6 S. W. Rep. 64; Bank *v.* Lovitt, 114 Mo. 519; s. c., 21 S. W. Rep. 825. In this last case, which is quite analagous to the case in hand, we held that: 'An officer of a banking corporation has a perfect right to transact his own business at the bank of which he is an officer, and in such transaction his interest is adverse to the bank, and he represents himself and not the bank. The law is well-settled that where an officer of a corporation is dealing with it in his individual interest the corporation is not chargeable with his uncommunicated knowledge of facts derogatory to his title to the property which is the subject of the transaction.' A corollary of the foregoing proposition is that if a person is an officer of two corporations, and these corporations enter into dealings with each other, the knowledge of the common officer cannot be attributed to either corporation in a transaction in which he did not represent it."

[2] Duncan *v.* Jaudon, 15 Wall. 165.

[3] Vermont Mining Co. *v.* Windham County Bank, 44 Vt. 489. As to the effect upon the teller of the bank of knowledge of a cashier that a note acquired by the bank was fraudulently negotiated, see Fall River Union Bank *v.* Sturtevant, (1853) 12 Cush. (Mass.) 374. As to the declarations of officers not admissible against a bank to prove facts, see Pemigewassett Bank *v.* Rogers, 18 N. H. 255, 261; Grafton Bank *v.* Woodward, 5 N. H. 301, 308.

that certain shares of stock in an investment company were sold by the president of the company, in payment for which the cashier gave him credit on the books of the bank for the agreed price of the stock. The shares were then placed in an envelope marked and figured as an item in the cash account for a sum in excess of the agreed price. The cashier afterwards abstracted from the envelope the amount in excess of the agreed price and appropriated it to his own use. Upon this fact being afterwards ascertained on an examination of the bank's affairs, an action was brought by the bank against the cashier to recover this amount. His defense was that it was his private transaction. The main question presented to the Supreme Court was as to a ratification by the bank of the acts of the cashier by which he claimed that the transaction was his and not that of the bank, so that the profits would belong to him. The Supreme Court approved the following instructions by the trial judge upon this point: "In regard to this transaction the defendant claims that he purchased said stock as an individual and not as cashier, for himself and not for the bank, for eleven thousand dollars; that he borrowed the money of the plaintiff bank to pay therefor, and that thereafter he sold said stock to plaintiff for fourteen thousand three hundred and fifty dollars; and, further, that March 31, 1891, [after he had ceased to be cashier] a final settlement between the plaintiff and defendant was had, and that the facts in regard to said transaction were fully made known to plaintiff, and that, with full knowledge of all said facts, plaintiff ratified and approved the same, and that thereby plaintiff is estopped from claiming thereupon. The jury are instructed that if they find that at said time, or at any time subsequent to the transaction, the plaintiff, with full knowledge in regard to all the facts in relation thereto, acquiesced in and adopted and ratified said transaction, then they are estopped from now recovering thereon, and in this issue you should find for the defendant. And, further, you are instructed that as soon as the facts were known to plaintiff's directors, if they were ever known, it was their duty to either adopt the transaction or repudiate it; and, if they elect to repudiate it, they should repudiate it altogether. They cannot repudiate it in part and adopt it in part. But, as to all acts prohibited by law, no affirmative act of repudiation is necessary. The law presumes that they are repudiated, and will not presume or infer an affirmance. Such acts, to estop plaintiff from recovery thereon, must be expressly ratified, and with full knowledge of all the facts in relation thereto; and the burden of proof is upon the party who relies upon a ratification of such unauthorized and unlawful act to prove that the principal, having such knowledge, acquiesced in and adopted and ratified such acts of its servants and agents." [1] The Supreme Court of Iowa also in this case approved the refusal of the trial judge to allow the defendant to show a custom of the officers of the bank whereby the defendant, its cashier, had been permitted, from time to time since the organization of the bank, to make loans to himself, giving his notes or other securities as he thought proper.[2]

[1] Iowa State Sav. Bank *v.* Black, (Iowa, 1894) 59 N. W. Rep. 283. It was said by the court: "Appellant complains of the instruction in that 'the term 'expressly ratified' calls for a higher degree of action and a more definite specific performance than the law requires.' A purpose of the instruction was to inform the jury as to plaintiff's rights and duties in matters where the acts of the defendant were prohibited by law, and that as to such matters the law will presume that they were not acquiesced in or approved until expressly ratified. The phrase is not to be understood as requiring a ratification in terms, for there is no evidence of such a ratification. As a matter of fact, the bank did not in terms ratify defendant's act, and hence the jury must have understood that the instruction meant that the intent to approve the acts must have been plain or clear. With that view the instruction is not erroneous. It is said that it is error to say of such acts that the law 'presumes that they are repudiated, and will not presume or infer an affirmance.' It is certain in such a case that the presumptions of the law are against ratification. The law will not presume that one person ratifies the unlawful acts of another. The instruction means no more than that, in the absence of proof of an intent to ratify the acts of defendant, the presumptions of the law are against it. The law does not require one man to affirmatively repudiate the unlawful acts of another or presume his approval or affirmance of them."

[2] Iowa State Sav. Bank *v.* Black, (Iowa, 1894) 59 N. W. Rep. 283. The court said: "The object of the testimony was to prove that the officers of the bank allowed defendant to make illegal loans to himself and thus estop the bank from showing that the loan, now claimed by them, was not legal. The court, speaking of the defendant, said to the jury: 'He had no right or authority as such cashier to loan himself as an individual or to use in any manner for himself the funds of the bank, and all such acts are wholly unauthorized and contrary to law.' The instruction is but expressive of the statute law of the state regulating state banks, and the policy of the law is public. It cannot by any custom of the officers of the bank be disregarded with impunity. The security of the bank against such practices is, in a very important sense, the security of the public in dealing with the bank. A design of the law was to

§ 311. Act of cashier binding upon the bank — illustration.— The cashier of a national bank had a note executed by a certain party payable to his bank discounted by another bank, upon the usual indorsement of his bank by him as cashier. Just before this note was falling due, the same party executed a note for a larger sum payable to the cashier individually. This note he indorsed individually and then placed the indorsement of his bank by him as cashier in the usual manner. He then presented before the other note was due this second note for discount to the same bank. They discounted it and upon his request applied a part of the proceeds of the discount to the payment of the other note and gave the bank's check to them for the balance, The bank discounting this note brought its action in a Minnesota court against the receiver of the bank represented by this cashier, such bank having become insolvent, to have the sum due on the note adjudged a legal claim upon the assets of the bank in his hands. Among the findings of the court below was one that "the plaintiff [meaning its officers] in good faith believed that [the negotiator with it in the transactions] was acting as cashier of said bank in said transaction, and had no evidence to the contrary, and no reason to believe anything to the contrary, except what appeared by said proceedings and said notes hereinbefore specified; that said plaintiff gave credit to said [insolvent] bank, and to said [negotiator] in all of said transactions." Also this finding: "Both of said notes were made by said [maker] and by her delivered to said [negotiator] for his individual use and accommodation; but plaintiff had no notice or knowledge thereof, except as shown by the notes themselves, until after it had discounted them." There was an insistment, on behalf of the receiver, that the plaintiff's cashier, who discounted the note in suit, was not justified upon these facts in supposing that the negotiator was acting officially, as cashier of the insolvent bank, in procuring the money on the note; and that his statements or conduct in the transaction were immaterial, in view of the fact that the note showed on its face that it appeared to be his individual note, and he had no authority in fact to make an accommodation indorsement thereon in behalf of the bank. The Supreme

prevent such loans being in any way would defeat a principle, if not the made and to permit the proposed entire purpose, of the law."
showing by defendant as an estoppel

Court held that in view of the fact that this negotiator was the acting cashier of the insolvent bank, entitled to make indorsements in this form of paper belonging to the bank, and presented himself in that capacity in this instance, the paper itself bore no marks of suspicion sufficient to affect the title of the bank as a purchaser in good faith, which, upon the facts, would otherwise be presumed.[1]

§ 312. Promise by cashier to pay draft of a customer to be drawn at a future day — not binding on the bank.— A national bank is empowered by United States Revised Statutes (§ 5136) "to exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental

[1] Merchants' National Bank of St. Paul *v.* McNeir, (1892) 51 Minn. 123. The court said: "[The negotiator] assumed to be acting in his official capacity, and appeared to be engaged in the business of his bank. He proposed to take up the note which he had before rightfully negotiated in behalf of the bank as cashier, and to substitute another executed by the same party. And the cashier of the plaintiff bank, as the court finds, in good faith, believed that [he] was acting officially for [his] bank, and the evidence sustains this finding. If the new note had been of the same amount as the old one taken up, the fact that it ran to [the negotiator] would hardly be claimed to be sufficient to excite suspicion. And so, if the note had been subsequently negotiated by plaintiff, and had passed in the regular course of business into the hands of a remote indorsee, it would hardly be claimed that such indorsee was not a *bona fide* purchaser, either on the ground of notice from the note itself, or that he was bound to have instituted a preliminary inquiry as to the authority of [the negotiator] to make the second indorsement as cashier. The fact that [he] appeared to be the first indorser, and the bank the second indorser, was not, of itself, a circumstance so extraordinary or suspicious as to make the case one of gross negligence on the part of the plaintiff, and subject it to the imputation of bad faith in receiving the paper. Nor, in the face of the finding of good faith of the officers of the plaintiff in the transaction, did the circumstance that the surplus, over the amount due upon the old note, was paid directly to [the negotiator] either in currency or by check running to him, amount to notice of [his] intended fraud upon his bank, or make the plaintiff a purchaser *mala fide* of the note. It is not sufficient, under the rule applied to the transfer of negotiable paper, under the law merchant, that there be circumstances of suspicion such as would put a careful purchaser upon inquiry. The circumstances must be so pointed and direct as to amount to evidence of *mala fides*, in the absence of inquiry, or such as to be *prima facie* inconsistent with any other view than that there is something wrong in the title, and thus amount to constructive notice. 1 Dan. Neg. Inst. (4th ed.) § 796; 2 Rand. Com. Paper, §§ 998, 1001; Tied. Com. Paper, § 289; Freeman's Nat. Bank *v.* Savery, 127 Mass. 78, 79."

powers as shall be necessary to carry on the business of banking by discounting and negotiating promissory notes, drafts, * * * and other evidences of debt, * * * by loaning money on personal security," etc. It was held in the United States Circuit Court for the southern district of California that under no provision of the statute above referred to did the cashier of a national bank have power to bind the bank to pay the draft of a third person on one of its customers, to be drawn at a future day, when it expected to have a deposit from him sufficient to cover it, and that no action would lie against the bank for its refusal to pay such a draft.[1]

§ 313. Estoppel of a bank to deny the validity of an act of its cashier in drawing drafts on its correspondent, and fraudulently indorsing them.— In a very recent case before the New York Court of Appeals, which was an action by the receiver of an insolvent South Carolina bank to recover a deposit

[1] Flannagan *v.* California Nat. Bank, (1893) 56 Fed. Rep. 959. The court said: "In Bank *v.* Dunn, 6 Pet. 51, the court would not permit the president and cashier of the bank to bind it by their agreement with the indorser of a promissory note that he should not be liable on his indorsement. It is said it is not the duty of the cashier and president to make such contracts, nor have they power to bind the bank, except in the discharge of their ordinary duties." The court then referred to U. S. *v.* City Bank of Columbus, 21 How. 356, and afterwards said: In West St. Louis Sav. Bank v. Shawnee County Bank, 95 U. S. 557, where it was attempted, but unsuccessfully, to bind a bank as an accommodation indorser on the individual note of its cashier, the court said: "Ordinarily the cashier, being the ostensible executive officer of a bank, is presumed to have, in the absence of positive restrictions, all the powers necessary for such an officer in the transaction of the legitimate business of banking. Thus he is generally understood to have authority to indorse the commercial paper of his bank, and bind the bank by the indorsement. So, too, in the absence of restrictions, if he has procured *bona fide* rediscount of the paper of the bank, his acts will be binding because of his implied power to transact such business; but certainly he is not presumed to have power, by reason of his official position, to bind his bank as an accommodation indorser of his own promissory note. Such a transaction would not be within the scope of his general powers; and one who accepts an indorsement of that character, if a contest arises, must prove actual authority before he can recover. There are no presumptions in favor of such a delegation of power. The very form of the paper itself carried notice to a purchaser of a possible want of power to make the indorsement, and is sufficient to put him on his guard. If he fails to avail himself of the notice, and obtain the information which is thus suggested to him, it is his own fault, and, as against an innocent party, he must bear the loss."

of that bank in a bank in the city of New York, it appeared that the latter had debited the former with certain checks which the cashier of the insolvent bank had drawn upon the New York bank, payable to certain customers of the bank of which he was the cashier, and then indorsed the names of these payees upon the checks, making them payable to the order of a New York firm of brokers, who collected the amount of these checks from the bank upon which they were drawn. The New York Court of Appeals in its opinion referred to the discussion of the trial judge of the question of what the act of the cashier of the bank amounted to in law, as follows: "In his judgment, the cashier's indorsement of the checks in the name of the payee, which he had written in the body of the check, was not, in a legal sense, forgery. He said that act did not defraud the persons whose names were used as payees, nor the bank in New York, nor his own bank, but that the fraud consisted in the unlawful drawing of the check for his own purposes, with the intent to convert his own bank's funds. Regarding the transaction in that light, and the indorsement as a part of one continuous act of preparing the check so that the New York bank should pay the funds drawn upon to the indorsees, he very properly reached the conclusion that, so far as the New York bank was concerned, the cashier's intent was the intent of his bank, and, hence, the payment of the checks was conclusive upon it." Then it is said of the review of the legal questions by the General Term, sustaining the judgment of the trial judge dismissing the complaint: "Upon the question of the effect upon the transaction of the use by [the cashier] of names, as payees, of persons who were the customers of the bank, it is said in the opinion that that fact did not prevent the application of the principle which would govern if fictitious names had been selected and used for payees. They held, in substance, that the bank, through its authorized officer, had put in circulation paper, with knowledge chargeable to it, that the names of the payees did not represent real persons, and with the intention to indorse thereon the names of the payees, who, for all intents and purposes, were fictitious payees, and whose names were adopted and resorted to as a device to avoid suspicion." The Court of Appeals approved these two judgments.[1] A

[1] Phillips *v.* Mercantile National Bank of the City of New York, (1894) 140 N. Y. 556, 559, 560, affirming 67 Hun, 378. The Court of Appeals in their

national bank of the city of New York was the correspondent of a country national bank. One who, during the time in which the transaction in controversy in this case took place, was cashier, and during the remainder of the time was president of the country bank, all the time practically managed the bank, and his codirectors and other officers had little or no oversight of

opinion distinguished Shipman *v.* Bank of the State of New York, 126 N. Y. 318, in these words: "There it had been found that the checks were signed by the firm, in the belief that the names of the payees represented real persons entitled to receive the amount of the checks, and with the intention that they should be delivered to real payees and should not go into circulation otherwise than through a delivery to and an indorsement by the payees named. [The] employment [of their clerk] did not comprehend the drawing or indorsement of checks or drafts, and in indorsing upon the checks the names of the payees he committed the crime of forgery, because he was without authority in that respect and did so with the intention to deceive his employers, the makers, and to put their checks in circulation for his account. That was a case wholly other than was made out here. It was stated in the Shipman case that the maker's intention is the controlling consideration, which determines the character of the paper, and that the statutory rule, which gives to paper drawn payable to the order of a fictitious person, and negotiated by the maker, the same validity as paper payable to bearer, applies only when such paper is put into circulation by the maker with knowledge that the name of the payee does not represent a real person. The principle of that decision is quite applicable to the case at bar. Though [this cashier] selected, for the execution of his dishonest purposes, the names of persons who were dealers with his bank, it was in legal effect as though he had selected any names at random. The difference is that, by the methods resorted to, he averted suspicion on the part of the directors or other officers of his bank. The names he used were, for his purposes, fictitious, because he never intended that the paper should reach the persons whose names were upon them. The transaction was one solely for the fraudulent purpose of appropriating his bank's moneys by a trick which his position enabled him to perform. Concededly, if the names of the payees were of fictitious persons [the bank whose cashier drew these checks] would have had no claim upon the defendant; how, then, can the transaction be said to assume a different aspect because the names adopted were of known persons? As cashier, invested with the authority to draw checks upon the bank's accounts with its correspondents, instead of drawing them directly to the order of the parties, who he intended should get the moneys, he drew them to the order of persons who had no interest in them, and thereupon wrote their names under a direction to pay to the real parties, who were intended to be the recipients of the funds drawn upon. If the checks had been drawn directly to the order of the real parties, the defendant would undoubtedly have been protected in paying them. As it was, the payees were fictitious persons in the eye of the law, and the only real parties were the firms in New York, to whom the cashier sent them in such form as that they could draw the moneys upon them. The fictitious-

its affairs. He was engaged in stock speculations on his own account in New York, and drew from time to time, for his own purposes, in favor of a firm in New York, his brokers, on the bank balance with the New York bank. His brokers from time to time returned to that bank sums to be credited to the country bank. The latter, being ruined by fraudulent operations of its officer before mentioned, who disappeared, became insolvent and was placed in the hands of a receiver. This receiver brought his action against the firm of New York brokers to recover the sums so paid to them by this officer of the country bank out of the balance to the credit of the bank with the New York bank. The brokers claimed the right to offset the return payments made by them to the New York bank. The trial court ruled that they were not entitled to do it, and no question in respect of them was submitted to the jury. For this error the United States Supreme Court reversed and remanded the case for a new trial, holding that, at the least, it was a question to go to the jury whether the officers of the bank, other than the dishonest official, in the exercise of reasonable and proper care, could have ascertained that

ness of the maker's direction to pay does not depend upon the identification of the name of the payee with some existent person, but upon the intention underlying the act of the maker in inserting the name. Where, as in this case, the intent of the act was, by the use of the names of some known persons, to throw directors and officers off their guard, such a use of names was merely an instrumentality or a means which the cashier adopted, in the execution of his purpose, to defraud the bank, in an apparently legitimate exercise of his authority. The cashier, through his office and the powers confided to him for exercise, was enabled to perpetrate a fraud upon his bank, which a greater vigilance of its officers might have earlier discovered, if it might not have prevented. If his position and the confidence reposed in him were such as to enable him to escape detection for the while, then the consequences of his fraudulent acts should fall upon the bank, whose directors, by their misplaced confidence and gift of powers, made them possible, and not upon others who, themselves acting innocently and in good faith, were warranted in believing the transaction to have been one coming within the cashier's powers. It may be quite true that the cashier was not the agent of the bank to commit a forgery, or any other fraud of such a nature, but he was authorized to draw or check upon the bank's funds. If he abused his authority and robbed his bank it must suffer the loss. The distinction between such a case and the many other cases which the plaintiff's counsel cited from, is in the fact that it was within the scope of this cashier's powers to bind the bank by his checks. In transmitting them, made out and indorsed as they were, the bank was so far concluded by his acts as to be estopped from now denying their validity."

these moneys had been deposited to the account of the insolvent bank, and would or would not have accepted such deposits as the return of the moneys to the bank.[1] It appeared in a case that a bank clerk, the duty of whom it was to prepare exchange for the cashier's signature, so drew a draft for twenty-five dollars to his own order that the amount could be readily altered. After procuring the signature of the cashier to the draft by pretending that he wished to make a remittance of that amount, the clerk altered the draft so that it presented the appearance of a genuine draft for $2,500, indorsed it and had it discounted. It was sought in the action to hold the bank liable on this draft. The

[1] Kissam *v.* Anderson, (1892) 145 U. S. 435. Mr. Justice BREWER, speaking for the court, *arguendo*, said: "We think [the principle upon which the trial court acted, which was stated by counsel for plaintiff in his brief, as follows: 'It is settled by abundant authority that where one has taken the property of another damages are not mitigated by showing merely that the wrongdoer returned the property without the consent of the owner or applied it upon the owner's debts. It must appear still further that the owner consented to such action or that the proceeds were so applied under legal process without connivance of the wrongdoer, * * *'] does not control in this case. Defendants returned this money to the [country] bank. They deposited it with the [New York] bank, the correspondent of the [former], and the bank from which they received the money or the checks from the [former]. In fact, therefore, the money was placed where it was before it was taken — in the possession and under the control of the [country] bank. Not only that; the [New York] bank, in its due course of business, by monthly reports, informed the [country] bank that they had received this money, and held it subject to its order, and it was subsequently used by the [country] bank in drafts drawn by it in favor of other parties. If it be said that no officer of [this] bank knew of these deposits except [its cashier], the wrongdoer, and that he subsequently drew out most of these moneys in drafts to further other wrongs, the reply is that the other officers and directors of [this] bank were chargeable with knowledge of these deposits. If, through their negligence, they did not in fact know, that is a matter for which [this] bank and not the defendants were responsible. [Defendants] had no supervision over its affairs, no knowledge as to how those affairs were managed. They were not called upon to go to [the place of its location] and hunt up the various officers and directors, and inform them, one by one, personally, that these moneys had been deposited to their credit in the [New York] bank. It was enough that they deposited them, and that that bank, in the regular course of business, by monthly statements, informed the [country] bank that it received and held those moneys. The learned circuit judge seemed to be of the opinion that, as they had assisted [this cashier] in withdrawing these funds from the bank, they could not escape responsibility, unless the sum total of his defalcation was reduced by their deposits to an amount less than that received from him. In his opinion overruling the motion for a new trial he thus expressed himself: 'Here all the money returned by [the wrongdoer] was insufficient to replace his defalcation by an amount much larger than the sum sought to be recovered of the defendants, and the bank had no knowledge that he had returned anything to replace what he had misapplied until he had again misappropriated it. It is not unjust or unreasonable to compel the defendants to restore such of the funds of the bank as they received when they are unable to prove that the bank was not directly or ultimately a loser in consequence of their acts. It may be that [the wrongdoer] would have misappropriated the money of the bank in other ways if they had refused to receive the checks, but certainly one temptation would not have been in his path if he had found that he could not use the paper of the bank for his speculations with the same facility as though it were his own money.' But surely they cannot be held for his subsequent wrongdoing. If they have returned a part of that they assisted him in wrongfully withdrawing, they are *pro tanto* relieved from responsibility, and are not to be chargeable with his after misconduct, in respect to which they had no part. It will not do to say that they put the money where he could check it out, and, therefore, are responsible for what he did with it. They deposited it to the credit of the [country] bank, and it was for the officers and directors of that bank to take care of its deposits. The rule might be different if [the wrongdoer], the cashier of the [country] bank, was the only officer authorized to draw on the [New York] bank, or charged with knowledge of the state of the account; but the president and teller had equal authority, and were equally chargeable with knowledge; in fact, it appears that these officers did draw drafts on the New York bank and thus diminished the total of deposits, and the other directors, also, were under some obligations to know the affairs of the bank; and it will not do to say that the bank can ignore the negligence of all its officers and profit by their omission of duty."

[2] Exchange Nat. Bank of Spokane *v.* Bank of Little Rock, (1893) 58 Fed. Rep. 140.

United States Circuit Court of Appeals for the seventh circuit affirmed the judgment rendered in the Circuit Court in favor of the bank, holding that the forgery by the clerk, and not the negligence of the bank, being the proximate cause of the loss, the bank was not liable. Further, the bank was not liable on the ground that the forgery was committed by its confidential employee, because in this transaction he acted as a purchaser, and not as an employee, and the purchase of the draft being complete, he was the owner of it when the forgery was committed.[1]

§ 314. Teller and bookkeeper — their powers and duties. —There is no inherent, original power expressly conferred upon the teller of a bank, in the powers and duties usually conferred upon such officer and to be exercised by him, to enable him to certify that the checks of the depositors of the bank will be good when presented for payment at some future time; nor is such

power incident to, or necessary to, the faithful discharge of any of his duties.[1] The court further held that a jury would not be warranted to infer such a power in a teller from evidence that the teller of the bank during all the time of his holding office whenever the convenience of the bank or of its customers required it, certified that checks were "good" which were drawn on the bank by its customers when funds to the amount of such checks were to the credit of the drawers, and his so doing was in some instances known to the bank and was not forbidden, or that it was the usage of the tellers of other banks to do the same; further, that the usage of issuing certificates of deposit by a teller of a bank was not evidence to prove a usage of certifying checks.[2] The teller of a bank in New York had general authority to certify checks, qualified by directions not to do so without funds, and to enter them in the books. He certified checks in violation of these instructions under a fraudulent arrangement with the drawer. The bank was held liable to a *bona fide* holder for value of the checks. The court further held that the delay of a year in presenting the checks for payment did not impair

[1] Mussey *v.* Prest., etc., Eagle Bank, (1845) 9 Met. (Mass.) 306. In the opinion the usual duties of such officer are thus stated: "The office of the teller is implied in the word used to designate it — to tell or count the moneys of the bank, which are received or paid out. The office is often divided into two branches, that of receiving teller and of paying teller, where the business of the bank is large and the duties cannot conveniently be united in one person. When united, the duty of the teller is to receive all moneys offered at the bank in payment of notes and bills previously discounted or lodged for collection as they severally fall due, and all moneys offered by customers of the bank to be deposited to their credit on account, whether arising from moneys brought by them to the bank, or the proceeds of discounts made for them; to pay the checks of depositors as the money is from time to time drawn out, or for notes discounted; and to redeem the bills of the bank with specie when the same is demanded. This is his official employment; and in the discharge of these duties he is regularly to account for the moneys he has received and paid out, not only to prevent mistakes, but to charge him when short or delinquent; and he is also made responsible for the payment of a check when the drawer has not a like amount to his credit unless he applies to the bookkeeper for information as to the state of the drawer's account; and then, if an overpayment is made through the mistake or fault of the bookkeeper, he and not the latter is responsible for the loss. And when checks on other banks are received in payment or on deposit (as is the usage among the banks of the city), it is made his duty to attend to their collection by a given hour of the day."

[2] Mussey *v.* Prest., etc., Eagle Bank, (1845) 9 Met. (Mass.) 306.

the holder's right.[1] A bank will be estopped by its teller, upon the presentation of a check bearing a forged certification, he being the officer whose certification it purports to be, pronouncing the certification genuine.[2] In a New York case it appeared that after the certification of a check it was raised and the name of the payee changed. The check was then tendered to the plaintiffs in this case, who sent it to the certifying bank during the busy part of the day, and its teller was asked if the check was good. Before this inquiry the drawer of the check had requested the bank to stop payment. The teller, however, responded affirmatively to the inquiry made as to the check being good. The Court of Appeals of New York held that the failure of the paying teller to call attention to the fact that the bank had been notified that the check had been lost in transit to the payee and that its payment had been stopped, which facts were entered upon the bank's register of certified bills, amounted to negligence which would authorize a recovery against the bank; further, that the fact that the teller did not know that the draft presented was the one the payment of which had been stopped, and his good faith in making the answer would not prevent a recovery.[3] Should the teller of a bank enter a check purporting to be drawn upon the bank in the bank book of a depositor as cash, and it should turn out that the check was forged, the bank would have to bear the loss.[4] Should the teller of a bank, after receiving, as cash, an invalid check upon another bank, consent to take it as his own and look to the drawer of the check for its payment, he cannot, afterward, without the consent of the bank authorities, return it to the bank.[5] A paying teller of a national bank has no power, without the sanction of its directory, to receive after banking hours a post-dated check and to agree, for the convenience of the holder of the check, that he will hold it until the day it is presentable and will then cause an account to be opened by the bank with the holder and the amount of the check placed to his credit so that it can be drawn against.[6] The functions of a note

[1] Farmers' & Mechanics' Bank *v.* Butchers' & Drovers' Bank, (1855) 4 Duer, 219; affirmed in 16 N. Y. 125.

[2] Continental National Bank *v.* National Bank of the Commonwealth, (1872) 50 N. Y. 575.

[3] Clews *v.* Bank of New York, (1889) 114 N. Y. 70; s. c., 22 N. Y. St. Repr. 397.

[4] Levy *v.* Bank of the United States, 4 Dall. 234; s. c., 1 Binn. (Pa.) 27.

[5] Union Bank of Georgetown *v.* Mackall, 2 Cranch Cir. Ct. 695.

[6] Averell *v.* Second National Bank, (1890) 8 Mack. (D. C.) 246. As to a post-dated check the court said: "It should in due course of business be

teller of a bank do not extend to the erasure of the name of one of several makers of a note, simply upon his request.[1] A bank will not be bound by the statement of its teller that the indorsement upon a check is genuine.[2] It is a gross violation of duty for the officers of a bank to honor a check or draft beyond the drawer's deposits.[3] A bank will not be bound by an agreement of one of its officers to give notice to a surety in case of a default on the part of the makers of a note pledged as collateral, in the absence of proof that authority was conferred upon the officer to make it.[4] In paying a debt due to a bank in good faith upon demand of one whom he finds as one of its officers employed in its business behind its counter, without any knowledge that the officer's authority is so limited that he has no right to receive it, the bank will be bound by the payment.[5] The bookkeeper of a bank or his sureties will not be relieved from liability on his bond which provides that he would strictly account for all moneys belonging to the bank and apply its funds to their proper uses, by the consent of the cashier to the taking by the bookkeeper of money of the bank not due him and appiying it to his own use.[6] If, in receiving as cash the check of an individual of good credit upon another bank, in which it afterwards appeared that he had no funds, the teller of a bank does only what is usual in the ordinary course of trade and business of banking and the usage of banks in like circumstances, his so taking it would not be a breach of the condition of his official bond to make good to the bank all damages it should sustain through his unfaithfulness or want of care.[7]

presented by the holder on the day of its date. It is payable only on that day or after. The duty of the banker is simply to pay his customers' checks over the counter when presented on or after their date. It is no part of his business to receive post-dated checks before they are payable and to engage to present them to himself, or, in other words, to consider them as presented to him for payment on the day when they are payable. Still less is it his business to engage in advance to pay checks which are post dated as before mentioned. If he should do so it would be at his own risk, for he could not refuse to pay other checks that might be presented in the meantime, although such payments would leave nothing to meet the post-dated checks."

[1] Marine Bank of Chicago *v.* Ferry's Admr., (1860) 40 Ill. 255.

[2] Walker *v.* St. Louis National Bank, (1878) 5 Mo. App. 214.

[3] Eichelberger *v.* Finley, 7 H. & J. (Md.) 381.

[4] New Hampshire Savings Bank *v.* Downing, 16 N. H. 187.

[5] East River National Bank *v.* Gove, (1874) 57 N. Y. 597.

[6] Chew *v.* Ellingwood, (1885) 86 Mo. 260.

[7] Union Bank of Georgetown *v.* Mackall, 2 Cranch Cir. Ct. 695.

CHAPTER XI.

DEPOSITS AND CHECKS.

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§ 315. **General deposits.**— It is now perfectly well settled that the relation between banker and customer who pays money into the bank, or to whose credit money is received there on deposit, is the ordinary relation of debtor and creditor; and that when the bank receives the money as an ordinary deposit and gives credit to the depositor, the money becomes the funds of the bank and may be used by it as any other funds to which it may be entitled. It is accountable for the deposits that it may receive as debtor; and in respect to ordinary deposits, there is an implied agreement between the bank and the depositor that the checks of the latter will be honored to extent of the fund standing to his credit.[1] A deposit is general, unless made special by the depos-

[1] Hardy & Bros. *v.* Chesapeake Bank, (1879) 51 Md. 562, 585; Horwitz v. Ellinger, 31 Md. 492, 503; Foley *v.* Hill, 2 H. L. Cas. 28; Thompson *v.* Riggs, 5 Wall. 663; Bank of the Republic *v.* Millard, 10 Wall. 152, 155. As to the relation between general depositors and a bank, see Marine Bank *v.* Fulton Bank, 2 Wall. 252; Phœnix Bank *v.* Risley, 111 U. S. 125; Planters' Bank *v.* Union Bank, 16 Wall. 483; Boyden *v.* Bank of Cape Fear, 65 N. C. 13; McGregor *v.* Loomis, 1 Disney (Ohio), 247; Perley *v.* Muskegon County, 32 Mich. 132; Neely *v.* Rood, 54 Mich. 134; Knecht *v.* United States Savings Institution, (1876) 2 Mo. App. 563; Union Bank *v.* Tutt, (1878) 5 Mo. App. 342; State *v.* Keim, 8 Neb. 63, 67; First National Bank *v.* Gandy, 11 Neb. 431, 434; Seward County *v.* Cattle, 14 Neb. 149; Longbottom's Exrs. *v.* Babcock, 9 La. 50; Grant *v.* Fiol, 17 La. 162; Wall *v.* Spur-

itor, or it is made expressly in some particular capacity by him. On a general deposit there will be an implied promise on the part of the bank receiving it to restore not the same funds, but an equivalent sum when demanded.[1] This liability to pay out the same on the checks of the depositor is implied by the law, without a special contract to that effect.[2] The law implies, also, that where a bank receives bank notes for deposit, in the absence of any agreement to the contrary, that the bank takes them at its own risk.[3] And even though a bank should take bank notes with the understanding that the risk of their being good was to rest upon the depositor, yet, it is the duty of the bank, upon knowledge of the insolvency of the bank issuing the notes, to give legal notice of the fact to the depositor; and a failure to notify him will not be excused by the depositor's having knowledge of the fact.[4] A bank receiving a sum of money on deposit generally, must account to the depositor for the amount in good funds, and a local custom of bankers would not be admissible in evidence, to change the liability of the bank.[5] Whenever the relation of debtor and creditor exists between the bank and a depositor, the bank will be liable for any depreciation of the currency.[6] Where money is collected and mixed up with the general funds

lock, 10 La. 342; In re Louisiana Savings Bank, 40 La. Ann. 514. That money, checks or bill deposited by a general depositor in a bank become the property of the bank, and the relation of debtor and creditor between the bank and depositor is thereby created, see Matter of Franklin Bank, (1828) 1 Paige Ch. 249; Chapman *v.* White, (1852) 6 N. Y. 412; Commercial Bank of Albany *v.* Hughes, (1837) 17 Wend. 94; Marsh *v.* Oneida Central Bank (1861) 34 Barb. 298; Ætna National Bank *v.* Fourth National Bank, (1871) 46 N. Y. 82. Under what circumstances the trustee of a school district by a deposit in bank becomes the creditor of the bank, see Union School Township *v.* First National Bank, (1885) 102 Ind. 464.

[1] Brahm *v.* Adkins, 77 Ill. 263; McEwen *v.* Davis, 39 Ind. 109.

[2] Thompson *v.* Riggs, 6 D. C. 99.

[3] Corbit *v.* Bank of Smyrna, 2 Harr. (Del.) 235.

[4] Ibid.

[5] Marine Bank of Chicago *v.* Birney, 28 Ill. 90.

[6] Marine Bank of Chicago *v.* Chandler, 27 Ill. 525. In Kupfer *v.* Bank of Galena, (1864) 34 Ill. 329, a deposit of gold coin had been made in the bank prior to the passage of the "legal tender" laws by congress, and had been drawn out by checks paid in treasury notes. The Supreme Court of Illinois held that the bank was responsible for the value of the coin as compared with the notes in which the drafts or checks on this deposit were paid. As to the right to pay in treasury notes of the United States where the deposit was made in gold or other coin, see Thompson *v.* Riggs, 6 D. C. 99.

of a bank it becomes a general deposit to the credit of the party for whom the collection was made, and is governed by the rules which obtain in ordinary cases of deposit of money with banks.[1] In such case, therefore, should the funds after such mingling become depreciated, the bank must sustain the loss and not the one for whom the collections were made.[2] Where a depositor makes a deposit with a bank to his credit, with instructions to apply it to the payment of a claim against him held for collection, there must be an actual appropriation of the money for that purpose before it will operate a payment of the claim. Until this is done the instructions may be countermanded. The money deposited is the money of the bank and the depositor may draw upon it or direct its appropriation in some other way.[3] When a bank, in the ordinary transaction of its business, receives money on general deposit, the money thereby becomes the property of the bank and the bank becomes debtor to the depositor for the amount as so much money had and received, and any subsequent loss of the money or destruction of its value, falls on the bank. The depositor is only a creditor of the bank.[4] If the bank fail, and be unable to pay its debts in full, the depositor comes in only as a general creditor and can only receive his *pro rata* share of the assets.[5] Where money is deposited with a bank by a board of officials in their official relation, when superseded by the appointment of a new board, the money becomes subject to the check of the new board.[6] A banking corporation taking from another an assignment of all of its property, on, as a consideration, agreeing to pay all of the debts and liabilities of this other, and proceeding to conduct the business of banking, and crediting a depositor of the former with the amount of his deposit upon its own books of account, thereby assumes the relation to the depositor which the former owes to him.[7] The receipt of a cashier of a bank is evidence of a deposit in a bank.[8] In a New York case where a bookkeeper in the bank, as well as bookkeeper for one of

[1] Marine Bank of Chicago *v.* Rushmore, 28 Ill. 463.

[2] Ibid.

[3] Moore *v.* Meyer, 57 Ala. 20.

[4] Henry *v.* North Bank of Ala., 63 Ala. 527.

[5] Ibid.

[6] Carman *v.* President & Directors of the Franklin Bank of Baltimore, (1883) 61 Md. 467. The court refers to and comments upon Lewis *v.* Park Bank, 42 N. Y. 463, and Swartwout *v.* Mechanics' Bank of New York, 5 Denio, 555.

[7] Green *v.* Odd Fellows' Savings & Commercial Bank, (1884) 65 Cal. 71.

[8] State Bank *v.* Kain, Breese (Ill.), 75.

the bank's depositors, received from the latter money for the purpose of depositing it in bank, entered the amount in the ledger of the bank and in the depositor's bank book, but the money was not received by the latter nor entered in the cash book, it was held that in making the deposit the bookkeeper was the agent of the depositor and not of the bank, and that the bank was not accountable for the money intrusted by the depositor to the bookkeeper for deposit.[1] A credit on the books of a bank for a general deposit is an acknowledgment of the receipt of so much money.[2] A paper headed with the names of bankers, showing that a party had made a deposit with them, stating the amount thereof, and signed by them, has been held to be *bona fide* evidence of a general deposit against the bankers.[3] A pass book, given by a bank to a depositor, is not a written contract but is *prima facie* evidence that the bank has received the amounts on the dates therein stated, and binds the bank like any other form of receipt, and is open to explanation by evidence *aliunde*.[4] Should a bank receive the deposit of a minor it must honor his checks.[5] Should a bank credit a depositor with the amount of a check drawn upon it by another of its customers, and there be no want of good faith upon the part of the depositor, the act of crediting would be equivalent to a payment in money. And a bank, it has been held, could not recall or repudiate the payment, because, upon an examination of the accounts of the drawer, it was ascertained that he was without funds to meet the check, though when the payment was made the officer making it labored under the mistake that there were funds sufficient.[6] A check left with a bank for collection and credited to the depositor may be charged back to him in case the check proves a fraudulent one.[1] Where commercial paper is delivered to a bank under an arrangement that the depositor be allowed to draw against it, the paper becomes the property of the bank, and the depositor cannot thereafter claim it.[2] The mere discounting of paper and placing the amount thereof to the credit of a depositor who already has a large balance to his credit, will not make the bank a purchaser for value so as to protect it against infirmities in the paper. Entering the amount of the discount to the credit of the depositor simply creates the relation between the bank and depositor of debtor and creditor; and, as long as that relation remains and the deposit is not drawn out, the bank has simply promised to pay; the depositor has parted with no value and would not be entitled to the protection of a *bona fide* holder of paper.[3] But while the mere discounting of paper by a bank and placing the amount thereof to the credit of a depositor having already a balance to his credit will not constitute the bank a purchaser for value so as to cut off equities, yet, as by the discount and credit, it becomes a debtor to the depositor if before receiving notice of any infirmity in the paper it pays out on the checks of the depositor the full amount due him, including the discount, the bank thereby will become a purchaser for value so as to be entitled to full protection.[4] This rule would obtain though the depositor, by subsequent deposits or discounts, preserve a constant balance to his credit, for, in the absence of special facts demanding a different rule, payments are applied to the oldest debts.[5] The fact that the depositor be itself a bank and the regular correspondent of the discounting bank would not change the rules as already stated.[6]

[1] Manhattan Co. *v.* Lydig, (1809) 4 Johns. 377.

[2] Corbit *v.* Bank of Smyrna, 2 Harr. (Del.) 235. Whether a bank can go behind its cashier's entry on a depositor's bank book to prove that the amount deposited was a smaller sum has been queried in Johnson *v.* Farmers' Bank, 1 Harr. (Del.) 117.

[3] Brahm *v.* Adkins, 77 Ill. 263.

[4] Talcott *v.* First Nat. Bank of Larned, (Kans. 1894) 36 Pac. Rep. 1066. See Davis *v.* Bank, 53 Mich. 163; s. c., 18 N. W. Rep. 629; Bank *v.* Smith, 19 Johns. 116; Asher *v.* Bank, 7 Alb. Law J. 43; Anderson *v.* Leverick, (Iowa) 30 N. W. Rep. 39. The court distinguished Jassoy *v.* Horn, 64 Ill. 379, and Long *v.* Straus, 107 Ind. 94; s. c., 6 N. E. Rep. 123, and 7 N. E. Rep. 763.

[5] Bank *v.* Headley, 17 W. N. C. (Pa.) 557.

[6] City National Bank *v.* Burns, (1880) 68 Ala. 267; citing Chambers *v.* Miller, 13 C. B. (N. S.) 125; Levy *v.* U. S. Bank, 4 Dall. 234; Oddie *v.* National Bank, 45 N. Y. 735; s. c., 6 Am. Rep. 160; Bolton *v.* Richard, 6 Term Rep. 139; National Bank *v.* Burkhardt, 100 U. S. 686. The Alabama court distinguished Boyd *v.* Emmerson, 2 Ad. & Ell. 184, and Kilsby *v.* Williams, 5 Barn. & Ald. 815. See on the subject of drawing checks, Martin *v.* Morgan, Gow, 123; s. c., 3 J. B. Moore, 635; Peterson *v.* Union National Bank, 52 Pa. St. 206; National Gold Bank & Trust Co. *v.* McDonald, 51 Cal. 64; s. c., 21 Am. Rep. 697.

[1] Rapp *v.* Bank, 26 W. N. C. (Pa.) 458.

[2] Flannery *v.* Coates, (1883) 80 Mo. 444; Ayres *v.* Bank, (1883) 79 Mo. 421; Bullene *v.* Coates, (1883) 79 Mo. 426; Armstrong *v.* Exchange National Bank, 133 U. S. 433. When bankers will not be held liable as guarantors of a deposit made with other bankers, see Dustin & Musick *v.* Hodgen, (1868) 47 Ill. 125.

[3] Munn *v.* Second National Bank, (1883) 30 Kans. 412.

[4] Fox *v.* Bank of Kansas City, (1883) 30 Kans. 441.

[5] Ibid.

[6] Ibid. As to what constitutes a legal deposit of money in a bank and

§ 316. Depositors — duty and rights. — Depositors must know and conform to the ordinary usage of business of the bank.[1] Where one of two partners carrying on business in his own name deposits moneys of the firm in his own name in bank, the other partner will have the right, during the lifetime of his partner, to change the account, placing it to the credit of the firm, and after his death to draw against it as surviving partner.[2] Though a depositor's account may be deemed balanced, and the lapse of time be such that as a whole account it cannot be opened, yet particular items may be shown to be false.[3] A depositor is not precluded by a rule of a bank, that all payments made and received must be examined at the time, from showing afterwards that there was a mistake made in the entry of his deposit.[4] Neither will he be concluded by entries made in his deposit book by the bank in writing up his account if he has made objection to it within a reasonable time after the account was written up.[5] Where the entry of a deposit was made by the teller of a bank, and the amount was erroneously stated to him by the depositor's clerk, and the depositor questioned its correctness on the day of the deposit, as soon as he discovered a mistake had been made, the Supreme Court of New York held that the depositor should be allowed to recover from the bank the difference between the amount entered and the true amount.[6] The United States Supreme Court has held that a depositor in a bank was estopped to question the correctness of his bank account by omission to examine entries in his pass book and vouchers returned, and to report errors.[7] They also held that a depositor intrusting examination of his bank account and vouchers to his clerk, without proper supervision, was liable for loss by the clerk's forgeries, where the bank had used due care.[1] A check drawn by a depositor, never accepted and not accounted for, would be no obstacle to a suit for the deposit.[2] In an action against a depositor for an overdraft he may set off coupons, payable to bearer, for which the bank may be liable.[3] Should a depositor on the same day of his deposit, and before it is placed to his credit on the books of the bank, direct the cashier to change the deposit to the credit of another, which is done, and the money be drawn out on the checks of the latter, the depositor will not be allowed to recover the amount of the deposit from the bank.[4] As a general rule, deposits of money in bank, subject to the checks of the depositor, draw no interest. It seems that if there should be unreasonable and vexatious delay in payment the depositor may demand interest.[5] In an Illinois case it appeared that a depositor in a bank, expecting to be absent for a short time, gave his clerk and bookkeeper a power of attorney to draw checks on the bank against deposits for fifteen days only, and placed the power of attorney with the bank. After his return he resumed drawing his own checks. But after the expiration of fifteen days the clerk contrived to draw checks without the knowledge of the depositor, a part of which he applied to the business of his employer and appropriated the balance to his own use. In the depositor's suit against the bank to recover his deposits, the Supreme Court held that the bank was liable to the depositor for the moneys paid out on the checks drawn by the clerk after his agency ceased, so far

the bank's liability, see Jackson Insurance Co. *v.* Cross, (1872) 9 Heisk. (Tenn.) 283.

[1] American National Bank *v.* Bushey, 45 Mich. 135. As to the effect of usage of the bank upon other parties, see Leavitt *v.* Simes, 3 N. H. 14; Piscataqua Bank *v.* Carter, 20 N. H. 246, 248; Moore *v.* Waitt, 13 N. H. 415; Crosby *v.* Wyatt, 10 N. H. 318.

[2] Commercial National Bank *v.* Proctor, (1881) 98 Ill. 558.

[3] Manhattan Co. *v.* Lydig, (1809) 4 Johns. 377.

[4] Mechanics & Farmers' Bank *v.* Smith, (1821) 19 Johns. 115.

[5] Schneider *v.* Irving Bank, (1865) 1 Daly, 500; s. c., 30 How. Pr. 190. See Godin *v.* Bank of the Commonwealth, 6 Duer, 76, as to what amounts to an accounting between a bank and a depositor which will bind the latter.

[6] Mechanics & Farmers' Bank *v.* Smith, (1821) 19 Johns. 115. In Winter *v.* Bank of New York, 2 Caines, 337, a bank was held liable to the true depositor, though the deposit had been partly credited to one who falsely claimed to be the depositor, and the bank had parted with value to him on it.

[7] Leather Manufacturers' Bank *v.* Morgan, 117 U. S. 96.

[1] Leather Manufacturers' Bank *v.* Morgan, 117 U. S. 96.

[2] Jackson Insurance Co. *v.* Cross, (1872) 9 Heisk. (Tenn.) 283.

[3] Bank of the United States *v.* Macalester, 9 Pa. St. 475.

[4] Neff *v.* Greene County National Bank, (1886) 89 Mo. 581.

[5] First National Bank of Springfield *v.* Coleman, (1882) 11 Bradw. (Ill.) 508. The court said: "It cannot be said that there has been any unreasonable and vexatious delay, unless the debtor has thrown some obstacle in the way, or, by some management of his own, induced the creditor to prolong the term of proceeding against him. Sammis *v.* Clark, 13 Ill. 544; Hitt *v.* Allen, 13 Ill. 592. And the defending in good faith of a suit brought for the recovery of the money is not a vexatious delay. Aldrich *v.* Dunham, 16 Ill. 403." In Jassoy *v.* Horn, (1872) 64 Ill. 379, where payment of an account evidenced by the entries in a depositor's book had been repeatedly demanded and ten years had elapsed after the deposit of the money, the Illinois Supreme Court held that the delay of payment was vexatious and unreasonable and that interest should be allowed on the account.

as he had appropriated them to his own use.[1] It was insisted before the court that the court before which this case was tried had erred in rendering judgment for any greater sum than the amount checked out by the clerk before the bank book or pass book of the depositor was written up the first time, when all the checks were returned to the depositor. It was claimed that from that date, at least, the bank had the right to presume that the clerk had authority to draw checks. The Supreme Court, however, affirmed the judgment.[2] In a case where a bank received a deposit of a check under an agreement that the check should be paid out of the first unappropriated funds of the drawer that came in, and large sums came in from the drawer, but all appropriated, the bank was held not liable upon its agreement.[3] There must be a demand for payment before a suit can be brought against a bank for a deposit.[4] And this demand previous to a suit is indispensable to the maintenance of a suit for such deposit, unless circumstances are shown which amount to a legal excuse for not making such demand.[5] A depositor, however, would have an immediate cause of action against a bank and its stockholders for the amount of his deposit upon stoppage of payment by the bank.[6] An action against the bank cannot be maintained

[1] Manufacturers' National Bank *v.* Barnes, (1872) 65 Ill. 69.

[2] Ibid. The court said: "The same question arose in the case of Weisser *v.* Denison, 10 N. Y. 68. There, as here, a clerk had drawn checks in the name of his employer, and the pass book had been several times written up and the checks returned before discovery of the fraud. The court held that the balancing of the pass book and the return of the checks are for the protection of the depositor, and not for that of the bank, and the failure of the depositor to examine the checks is not such negligence on his part as to exonerate the bank from liability for the continued payment of checks improperly drawn. * * * The facts that the plaintiff [in the case before us] had been thus careful to give the clerk express written authority, and to limit it to fifteen days, and to lodge this authority with the bank, in pursuance of a previous arrangement, were sufficient to show the bank that the plaintiff had no intention of giving to the clerk a general authority to draw. The bank was guilty of great negligence in paying checks of the clerk drawn after that period, and cannot be excused merely because the plaintiff failed to examine the returned checks, which he had a right to presume had been drawn by himself alone. We consider the reasoning of the New York Court of Appeals, in the case cited, very satisfactory, and adopt its decision as the better rule."

[3] Johnston *v.* Bank, 101 Pa. St. 600.

[4] Downes *v.* Phœnix Bank, (1844) 6 Hill, 297.

[5] Brahm *v.* Adkins, 77 Ill. 263.

[6] Mitchell *v.* Beckman, (1883) 64 Cal. 117.

upon a certificate of deposit issued to one, "subject to order of himself * * * and payable on return of this certificate" before a demand for payment and a refusal to pay.[1] A depositor will be relieved from demanding the payment of his deposit as preliminary to the right to sue, by a notice from the bank, or by an advertisement, that his claim would not be paid at the counter.[2] Upon the suspension of a national bank and the appointment of a receiver, a depositor in the bank, from the date of his demand for it, will be entitled to interest on his deposit.[3] Where money may be deposited by the drawee in a bank to pay a certain draft, not there at the time, the drawers would have no interest on the money until the application to their draft is made. The drawee may revoke his direction at any time before the money is so applied.[4] In an Indiana case one who wished a loan of money employed a firm to negotiate it for him. They applied to another firm, who procured the money from their principal, a security company, and deposited it in bank. Soon afterwards the first party executed his note and mortgage for the amount and delivered them to the firm who had procured the money, and they, in turn, left a check on the bank, with one of the firm first named, to be delivered to the first party when he obtained the release of prior incumbrances on his land, which he agreed to do at a certain time. He did not carry out the agreement at the time fixed, nor subsequently, and ten days later, while the check was still in the keeping of others, the bank on which it was drawn failed. The court held that the loss was not his, and that he could maintain an action against the security company for the surrender and cancellation of the note and mortgage.[5] One keeping an account with a banking house, depositing funds which are at the time current, has a right to insist upon payment in current funds, although the funds deposited may, in the meantime, have depreciated in value.[6] There has been a case before the Supreme

[1] Brown *v.* McElroy, (1876) 52 Ind. 404.

[2] Farmers & Mechanics' Bank *v.* Planters' Bank, 10 G. & J. (Md.) 422. That demand must be made for payment of deposit before action to recover it, see National Bank of Fort Edward *v.* Washington County National Bank, (1875) 5 Hun, 605.

[3] National Bank *v.* Mechanics' National Bank, 94 U. S. 437.

[4] Bank *v.* Higbee, 109 Pa. St. 130.

[5] Security Company *v.* Ball, (1886) 107 Ind. 165.

[6] Willetts *v.* Paine, (1867) 43 Ill. 432.

Court of Michigan in which it appeared that the two members of a firm joined in a letter to the bank, in which the firm kept an account, instructihg it to pay no checks on the part of the firm unless they were countersigned by a son of one of the partners, who was the bookkeeper of the firm. The other partner made an arrangement with the bank by which he was to get money for their business at another point where he conducted it. He drew a number of checks in the name of the firm at different times which were not countersigned by the bookkeeper. A check drawn in this way finally came back to the bank not paid, and was charged up to the firm. For overdrafts on this account the bank brought its action against the firm. On the trial of this action there was no showing by the bank that the firm derived any benefit from the moneys received upon these checks, it resting its claim upon the contract implied from the signing of the checks in the firm name. The majority of the court affirmed the judgment of the trial court in favor of the firm.[1] A person

[1] Gladstone Exchange Bank *v.* Keating, (1892) 94 Mich. 429. MONTGOMERY, J., speaking for the majority, said: "It is suggested that the burden of proof would rest upon the defendants to show that the moneys did not go to the benefit of the firm. In my judgment, this is not the correct rule in such a case. The [bank] seeks to recover, notwithstanding it appears affirmatively that the money was paid out by it upon checks which were drawn without the requisite authority of the firm. There can be no doubt about the power of either member of a copartnership to protect himself by stipulating that the other member shall not have the authority to bind the firm by signing checks, if notice is given to the bank which is the depository of the firm; and when, on the affirmative showing of the bank, as in this case, it appears that the bank has disregarded the notice, how can it be said that a *prima facie* case is shown, without further showing that some benefit was derived by the firm from the payment of the money? It is suggested in the case that the defendants are estopped from relying upon this defense, for the reason that there was an opportunity for an examination of the account and checks, and that the defendants should have examined these checks, and notified the [bank] of the excess of authority and of the invalidity of the checks." The case of Bank *v.* Morgan, 117 U. S. 96, cited to sustain this position, was distinguished in the opinion of the Michigan Supreme Court, as follows: "But in the case cited, the party drawing the check had *prima facie* authority to draw it; the bank acted in good faith in making the payment; the check passed back into the hands of the drawer, with opportunity to examine and observe the error; it appeared charged in the account of the drawer. Under these circumstances, it was held that there was a duty to notify the bank, in order that it might protect itself. But what notice was requisite in this case to enable the bank to protect itself? The moment it paid one of these checks, its officers knew from direct notification that they were violating the express instructions and directions of defendants. Why notify them of what they already knew? If either party was entitled to notice of this transaction from the other, it was certainly the two defendants, as individuals, who were entitled to notice from the bank that some person connected with the firm was assuming to violate the express instructions of the firm, of which the bank, as well as the defendants, was apprised." GRANT, J., dissented on each of the points just discussed.

depositing money with one bank, to be transmitted for his use and benefit to another bank, which refuses or is unable to receive it, and cannot be compelled to receive it, the purpose of the deposit failing, the bank so receiving the same will hold it to the use of the depositor, and must account to him for it. Money so deposited and expressed in the certificate of deposit, to be forwarded in the usual course of business, cannot be regarded as assets of the bank to which it was to be remitted, and the bank receiving the deposit cannot apply the same in payment of debts due from the correspondent bank, nor would such money be subject to garnishment at the suit of creditors of that bank.[1]

§ 317. When ownership of deposit is questioned — rules.— In a controversy over the right to a bank deposit where it is denied that the depositor was the owner of the fund, and entitled to draw the same from the bank, it may be shown that the ownership of the deposit is in another, and that a payment to him releases the bank from liability.[2] A receiver of a corporation appointed upon the removal of a former receiver drawing a check upon the bank, where the receiver's deposits of funds had been made for a supposed balance due on that account, the bank declined to pay it on the ground that there was no such balance. The evidence showed the payment of a check by the former receiver drawn to an individual for the amount of money received by him belonging to her and deposited to the credit of the receiver's account. In an action upon the protested check the bank had judgment in its favor. Upon appeal the Maryland Court of Appeals affirmed this judgment, holding that where such a receiver had deposited to his credit, as receiver, money belonging to an individual, the corporation was under obligation to repay such person, and was, therefore, not prejudiced by the

[1] Drovers' National Bank *v.* O'Hare, (1887) 119 Ill. 646; s. c., 10 N. E. Rep. 360; followed in Union Stock Yards Nat. Bank *v.* Dumond, (1894) 150 Ill. 501; s. c., 37 N. E. Rep. 863.

[2] Wichita Nat. Bank *v.* Maltby, (Kans. 1894) 36 Pac. Rep. 1000.

giving of a check by the receiver to the individual in payment of the obligation.[1] Neither the bank nor the attorney can deny that money deposited by the depositor as attorney for another belongs to the latter.[2] Money credited to a depositor may be shown to be the property of a third person and be reached by attachment against the latter, or he may stop payment by proper notice. In the absence of any extrinsic claim, however, to the money the bank would be bound to honor the depositor's check.[3] In the absence of proof of fraud a deposit in the name of a third person is *prima facie* a payment of a debt due him, and the third person's ownership will be good as against all other persons.[4] The *prima facie* presumption is that money deposited in a bank belongs to the person in whose name it may have been deposited; if claimed by another person the burden of proof would be upon him to establish his ownership.[5] And a bank will not be permitted to allege that money received by it from a depositor belongs to some one else.[6] In an Ohio case a party deposited money in one bank to the credit of another bank, but, without knowledge of the latter, took a letter from the bank securing the deposit, addressed to the one credited with the deposit, advising it of the deposit, and afterwards delivered the letter to a third person, with his own name indorsed on the letter in blank, for presentation to the bank credited with the deposit. The court held that, as between the depositor and the latter bank, the bearer of the letter had authority to control the fund, and, for that purpose, to write a check or order over the blank signature; also, it was held that the fact that this bank held the note of the party making the deposit, then overdue, did not constitute a notice that the fund was to be applied to the payment of this note.[7]

[1] Eccles *v.* Drovers & Mechanics' Nat. Bank, (Md. 1894) 29 Atl. Rep. 963.

[2] Burger *v.* Burger, 135 Pa. St. 499; s. c., 26 W. N. C. (Pa.) 355.

[3] Hemphill *v.* Yerkes, 132 Pa. St. 545; s. c., 25 W. N. C. (Pa.) 417.

[4] Ferry *v.* McKenna, 9 Pa. Co. Ct. Rep. 17.

[5] Egbert *v.* Payne, 99 Pa. St. 244.

[6] Bank *v.* Alexander, 120 Pa. St. 476.

[7] Weirick *v.* Mahoning County Bank, (1866) 16 Ohio St. 296. See Ring & Rice *v.* Foster, 6 Ohio, 279; Mitchel *v.* McCabe, 10 Ohio, 405; Moore *v.* Gano, 12 Ohio, 300; Howe *v.* Hartness, Hill & Co., 11 Ohio St. 449; Cornwell *v.* Kinney, 1 Handy (Ohio), 496; Fullerton *v.* Sturges, 4 Ohio St. 529; Putnam *v.* Sullivan, 4 Mass. 45; Selser *v.* Brock, 3 Ohio St. 307. In Tradesmen's Bank *v.* Astor, (1833) 11 Wend. 87, the facts were that the president of the bank became treasurer of a voluntary association, and as treasurer opened an account with the bank, depositing the funds of the association therein, which account he overdrew. It was held that the bank could recover the amount overdrawn from the members of the association as he drew upon the account as the agent of the association.

A bank cannot claim a lien upon a bank account opened with it by one as the general agent, when it knows that he is agent of a corporation, for an individual debt of the depositor to the bank.[1] A factor depositing money in a bank which has knowledge that it is the proceeds of sales of goods for his principal's account, and the principal's ownership, the bank will not be allowed, as against the principal, to appropriate the deposit to payment of a general balance due from the factor to the bank.[2] A bank refusing, without cause, to honor a depositor's check has been held liable for substantial damages, though no special loss was shown.[3] In case a bank, with which an agent or trustee has deposited money belonging to his principal or beneficiary, without his authority, and in ignorance of the true ownership of the fund, applies the deposit to a debt which the depositor may owe it, the owner would not be debarred by that fact from recovering the money from the bank if it can be identified.[4] The rule that a trustee may follow trust property as long as it can be traced has no application in an action to recover money as a general deposit in a bank.[5] As against a depositor, a bank cannot allege that the fund in its hands belongs to a third person against whom the bank has a counterclaim.[6] A bank would not be authorized to pay out money on check of a depositor in his individual name where the deposit has been credited to him as trustee.[7] The money belonging to a county deposited by a county treasurer in a bank in his name as "treasurer," no money of the treasurer being mixed with it, upon his becoming a bankrupt, belongs to the county, and it would be no defense in an action against the bank to recover the deposit that it had been paid to the assignee in bankruptcy of the treasurer.[8] There is justification for payment by a bank of money upon orders of the one depositing the money or his agent, until notice

[1] National Bank *v.* Insurance Co., 104 U. S. 54.

[2] Union Stock Yards Bank *v.* Gillespie, 137 U. S. 411.

[3] Patterson *v.* Bank, 130 Pa. St. 419.

[4] Burtnett *v.* First National Bank, 38 Mich. 630.

[5] McLain *v.* Wallace, (1885) 103 Ind. 562.

[6] Bank *v.* Mason, 95 Pa. St. 113.

[7] Ihl *v.* Bank of St. Joseph, (1887) 26 Mo. App. 129.

[8] Supervisors of Schuyler County *v.* Bank of Havana, (1875) 5 Hun, 649.

is received of an adverse claim of ownership of the funds.[1] Where a bank is notified of adverse claims to a deposit, as that a depositor has parted with his interest, and others have succeeded to his rights by his act or through operation of law, the bank would not be justified in paying the depositor.[2] When a bank is enjoined by a court from paying the sum deposited with it, either to the depositor or to his assignee, it is its duty to obey the mandate of the court, and not to pay out the funds deposited with it until the parties claiming the same can have an opportunity to contest, by interpleader or otherwise, the good faith of the assignment.[3] Should a bank pay to any person other than the depositor the money he may have deposited with it, the bank would be required to show not only that the money did not belong to the depositor, but that it did belong to the person to whom it was paid.[4] Where money belonging to one person had been deposited in a bank in the name of another, the bank's payment to the committee of the real owner of the money (the owner having became a lunatic) was held by the New York Court of Appeals to have been legal and to have discharged the bank, and that it was a protection against the equitable claim of a third person to whom the one in whose name the money was deposited had given a check, of which facts the bank had no notice.[5]

§ 318. The passing of title by deposit of a check.— Whether the title to a check deposited with a bank passes to the bank before collection, so as to immediately create the relation of debtor and creditor between the bank and a depositor, is a question of fact depending upon the circumstances and course of dealing in each particular case. Here certain checks marked "For deposit" were deposited in a bank at a quarter to three on Saturday, and credit was immediately given for the amount of the checks on the pass book of the depositor. The bank closed at three and the next day was declared insolvent with the checks still in its hands. The custom of the bank was, at the close of

[1] McEwen *v.* Davis, (1872) 39 Ind. 109.

[2] German Exchange Bank *v.* Commissioners of Excise, (Sup. Ct. N. Y. Spl. Term, 1879) 6 Abb. N. C. 394.

[3] Springfield Marine & Fire Ins. Co. *v.* Peck, (1882) 102 Ill. 265.

[4] Patterson *v.* Bank 130 Pa. St. 419.

[5] Viets *v.* Union National Bank of Troy, (1886) 101 N. Y. 563.

each day's business, to balance its books, crediting depositors with the amount of their checks, and, if a check was subsequently returned unpaid from the clearing house, it was charged off to the depositors. This depositor did not know of this custom. He had made deposits with the bank for several years without any special arrangement, and had never drawn against uncollected checks, except by particular understanding. On these facts the United States Circuit Court for the district of Massachusetts held that title had passed to the bank so as to create the relation of debtor and creditor. But these facts being alleged in the depositor's bill against the receiver of the insolvent bank, and connected with further allegations that, at the time the checks were received, the bank was "irretrievably insolvent, and made so by the operations of the president and two others of the directors," and that the depositor then believed it to be solvent, and had no means of knowing of its insolvency, the court held this was sufficient to show fraud, and to render the bank liable to return the checks or their proceeds. Further, it was not necessary for the bill to specifically allege that the officers of the bank had knowledge of its insolvency, since such knowledge would be implied from the allegation that the insolvency was caused by the president and two of the directors.[1] This case was on appeal before the United States Circuit Court of Appeals for the first circuit, and that court held that, under the circumstances of the case, no title passed to the bank by the deposit of the check "For collection," and that the depositor was entitled to the proceds of the check collected and passing to the receiver of the bank then insolvent.[2] One corporation which had

[1] City of Somerville *v.* Beal, Receiver, (1892) 49 Fed. Rep. 790.

[2] Beal, Receiver, *v.* City of Somerville, (1892) 50 Fed. Rep. 647. The opinion of PUTNAM, Circuit Judge, is an elaborate one, and it so learnedly discusses the whole question and so distinguishes the cases on this subject that we give it in this note. He said: "The fact that the checks were expressly indorsed 'For deposit,' does not change the nature of what occurred in this instance, as there are no intervening equities, although it emphasizes it. The paying of actual money by a customer into a bank of deposit does not create a bailment, because, by the settled customs, recognized by the Supreme Court of the United States, the House of Lords and numerous other courts, the bank is authorized to mingle the money at once with its general fund, creating immediately the relation of debtor and creditor, subject by further custom to draft in the usual course of business. But, with reference to the checks claimed by the city of Somer-

deposited a sight bill drawn upon another indebted to it in another city in a bank in which it kept its account, and the bank had credited it to the corporation on its books as a cash item, and the bank, which was insolvent at the time, forwarded the bill to its correspondent in the other city, who collected the same after the bank had failed and closed its doors, brought an action in the federal court for the southern district of New York against the

ville, the word by which the transactions ordinarily described may conveniently have, and, therefore, should have, its full natural force and meaning. A mere deposit would only require a bank to keep; but a usage requiring the Maverick to do in this case something more has continued so long, and is so notorious and universal, that the law can take judicial notice of it, and it happens that its terms and limitations cannot be mistaken. The bank must use due diligence to collect, and as collections are completed, the bank no longer holds the avails as bailee, but is authorized to mingle them with its other funds, and thus constitute itself a debtor. This, of course, makes the entire transaction something more than a mere deposit, in any proper sense, but this word well gives color to all that follows, and converts all that is due between the customer and the bank to and including the actual turning of the checks into money, into *locatio operis*, according to its meaning as explained by Judge STORY in his work on Bailments, chap. 6, art. 2. Aside from the right of the bank to constitute itself a debtor from the time the checks are converted into cash, or its equivalent, instead of a mere trustee or agent, no qualification of the strict legal relations created by a bailment is deducible from the general nature of the transaction, the terms in which it is expressed, or the settled custom, or is shown by the appellant. * * * The first impression coming from the fact that the deposit was immediately entered to the credit of the city in its pass book favors the view of the appellant; but a careful consideration will demonstrate that this was a mere matter of convenience, and the entry would have been the same on either theory, as was illustrated in Manufacturers' Nat. Bank *v.* Continental Bank, 148 Mass. 553; s. c., 20 N. E. Rep. 193, and Railway Co. *v.* Johnston, 133 U. S. 566; s. c., 10 Sup. Ct. Rep. 390. On the other hand, the appellant fails to show that the city had an absolute right to check against the deposit as soon as made, irrevocable by notice from the bank; and that such right did not exist must be received by this court as a matter of judicial knowledge, notwithstanding the parties in Moors *v.* Goddard, 147 Mass. 287; s. c., 17 N. E. Rep. 532, and the complainant in this case seem to have regarded it necessary to prove the practice of a particular bank with reference to this matter. This is inconsistent with any theory except that the bank is a bailee of deposited checks until they are collected; as is also the admitted fact that the bank is entitled to return to its customer an uncollectible check, though he neither indorses it nor gives any special agreement to that effect. The appellant fails to show any obligation to receive back such checks, unless from special custom; and it is more in harmony with fundamental principles to presume that this right to return grows out of the former than the latter. It strains the law to convert the natural incidents of a bailment into a right of an entirely

receiver of the bank to recover the sum collected on this sight bill. The question in the case was whether the draft belonged to the plaintiff at the time it was paid by the drawee. If it did the defendant did not acquire title to the money. If the transaction in controversy was equivalent to a discount of the draft the bank acquired the title to the paper; if it was not, the bank merely became the agent of the plaintiff to collect the proceeds. The

different character, to be sustained, if at all, by a custom violative of the ordinary rules governing analogous transactions. No authorities have been cited or found which bind this court to the contrary of what is hereinbefore expressed. Railway Co. *v.* Johnston, 133 U. S. 566; s. c., 10 Sup. Ct. Rep. 390, is not in point, as the paper in question in that case was not a check, but a sight draft, and the decision was made to rest mainly on the ground of fraud, as was stated by the learned judge from whose decree in the Circuit Court this appeal was taken. Ex parte Richdale, 19 Ch. Div. 409, is criticized in Balbach *v.* Frelinghuysen, 15 Fed. Rep. 675. It can be added to what is there said that so far as the case touches this at bar, the different judges who sat in the Court of Appeal used essentially varying expressions, all of which were unnecessary, beyond the proposition that the banker there in question was, under the special circumstances, a holder for value. Bank *v.* Loyd, 90 N. Y. 530, so much relied on as establishing an absolute title in the bank from the instant the checks were deposited, may perhaps settle the law for the state of New York. It apparently was so considered by Judge WALLACE as late as 1886, as stated in Railway Co. *v.* Johnston, 27 Fed. Rep. 243. The law of New York was especially found by the Supreme Court of Massachusetts to be as stated in Bank *v.* Loyd, in Brooks *v.* Bigelow, 142 Mass. 6; s. c., 6 N. E. Rep. 766, and though perhaps not of importance, yet it is noteworthy that the parties deemed it necessary to prove the rule of that state as though local and peculiar, and not to be gathered from the common law. Bank *v.* Loyd is discussed by the Supreme Court in Railway Co. *v.* Johnston, already cited; and its effect is stated (page 575, 133 U. S. and page 392, 10 Sup. Ct. Rep.) to be in substance that a transfer by a bank of a draft deposited for collection and indorsed generally, would confer title by reason of 'reputed ownership.' This was the pith of the New York decision, the question being, not as to title between the primary bank and its customer, but between the latter and another bank to which the drafts had been remitted. Bank *v.* Hubbell, 117 N. Y. 384; s. c., 22 N. E. Rep. 1031 (decided November 26, 1889), can be distinguished from the case at bar only by the fact that in the former the checks were expressly indorsed 'For collection.' They were charged by the depositor to the banker simultaneously with forwarding them, and were in like manner credited at once on reception and before collection, and such as were protested were charged back. The banker did not keep the proceeds of the collections distinct, nor remit them specifically; but they were mingled with his other funds, and remittances of balances were made each week. These covered the existing credits on the books of the banker, whether or not at that time collected. This method of business had continued

bill was dismissed.[1] The mere credit of a check upon the books of a bank, which may be canceled at any time, does not make the bank a *bona fide* purchaser for value. If, after such credit, and before payment for value upon the face thereof, the holder receives notice of the insolvency of the bank, it cannot become a

for many years. Notwithstanding the checks were indorsed specially 'For collection,' the transactions as a whole were identical in substance with those usual in connection with a deposit as made in the case at bar; and the course of proceedings and the practical construction given them by the parties were precisely the same as though the checks had been indorsed generally. The special indorsements effected nothing, except to give notice to a transferee or other stranger. They were covered into the transactions, and added nothing to them, because checks delivered a banker are 'For collection' in any view. The checks were accompanied with letters stating that they were indorsed 'For collection and credit.' The court said that this amounted to a direction to credit after the collection; but the practice was to credit before, so that the letters of advice were thus actually superseded. Moreover, as already said about the word 'collection,' the word 'credit' added nothing, and was entered into the transactions, because the banker could do this in any event unless instructed to remit specially. In this case the Court of Appeals held that the title to the checks remained in the depositor while they were uncollected. In Balbach *v.* Frelinghuysen, already cited, the United States Circuit Court for the district of New Jersey laid down as the result of its conclusions the rule that a bank is, until collection, a bailee of checks deposited, or agent of its customers' depository."

[1] St. Louis & S. F. Ry. Co. *v.* Johnston, (1886) 27 Fed. Rep. 243. WALLACE, J., having stated the question involved as stated in the text, discussed it in these words: "The case of Metropolitan Nat. Bank *v.* Loyd, 90 N. Y. 531 (affirming the same case in the Supreme Court, reported in 25 Hun, 101), is an authority directly in point against the plaintiff's right to recover. In that case the plaintiff deposited with the bank a check drawn upon another bank in a different city, indorsed by him, and the amount of the check was entered by the bank upon the pass book of the depositor as cash, with the depositor's knowledge. It was held that the bank became the owner of the check. The opinions delivered in this case, both in the Court of Appeals and in the Supreme Court, are a full and able discussion of the questions involved, and contain a full review of the authorities bearing upon them. On the other hand, the case of Balbach *v.* Frelinghuysen, 15 Fed. Rep. 675, decided by the Circuit Court of the district of New Jersey, follows the views expressed in Morse on Banks and Banking (page 427), and holds that the checks so deposited do not become the property of the bank, although by the course of business between the depositor and the bank the depositor has been allowed to draw against the deposits before the paper has been actually collected. Upon principle, there is no reason why, if the parties choose to treat the deposit of such paper as a deposit of cash, the transaction should not be deemed equivalent to a discount of the paper by the bank. Sight bills drawn by one corporation upon another of prominent financial standing, like the interest coupons of such

bona fide holder by subsequent payment.[1] A national bank in Dakota, with knowledge that the county treasurer of a county had not sufficient county funds in his hands to balance his official accounts, consented to give him fictitious credit in order to enable

corporation, or like certified checks upon banks, are generally accepted in commercial usage as the equivalent of money. They have practically the same attributes as bills issued by banking corporations, which are merely promises to pay at sight, and are everywhere accepted as money, in the absence of special circumstances affecting the financial standing of the corporation issuing them. Where bank bills are credited at their face to their depositors, and are treated by the depository as a deposit of money, the bank receiving them becomes a debtor to the depositor for the face amount, although the currency may at the time be depreciated. Marine Bank *v.* Fulton Bank, 2 Wall. 252. When a sight bill is deposited with a bank by a customer at the same time with money or currency, and a credit is given him by the bank for the paper, just as a like credit is given for the rest of the deposit, the act evinces unequivocally the intention of the bank to treat the bill and the money or currency without discrimination, as a deposit of cash, and to assume towards the depositor the relation of a debtor instead of a bailee of the paper. If the customer assents to such action on the part of the bank by drawing checks against the credit, or in any other way, he manifests with equal clearness his intention to be treated as a depositor of money, and, as such, as a creditor of the bank instead of a bailor of the paper. Under such circumstances it should be held that the bank acquires title to the paper just as it would to a deposit of money. The intention of the parties in the particular transaction may be ascertained from the course of their previous dealings. When it appears that it has been the uniform practice between the parties in their past dealings to treat deposits of paper as deposits of cash, their intention to do so in the particular transaction should be inferred, in the absence of new and inconsistent circumstances. It is quite certain that bankers do not invariably credit their customers for sight paper as for cash, but are generally influenced by the financial responsibility of the customer or the drawee of the paper, or both. If a bank does not wish to assume the relation of a debtor for the paper to the depositor, this intention may be manifested in a very explicit manner by crediting the paper as paper. This was done in Thompson *v.* Giles, 2 Barn. & C. 422, in the Case of Rowton, 1 Rose, 15, and in the Case of Sargeant, Id. 153. Some significance must be attached to a credit entry of the paper upon the books of the bank as cash, and the natural implication would seem to be that the bank, by making such an entry, assumes to receive the bill as money. Correlatively, if the depositor understands that the bank proposes to receive the paper as money, and assents, expressly or by acquiescence, it would seem that he consents to part with the title to the paper. For these reasons the conclusions reached in Metropolitan Nat. Bank *v.* Loyd. are adopted as satisfactory. The authorities bearing upon the general questions are so fully cited and discussed in the opinions in that case that it is deemed unnecessary for present purposes to refer to them."

[1] Dresser *v.* Missouri, etc., Construction Co., 93 U. S. 92; Mann *v.* Second National Bank, 30 Kans. 412; Central

him to impose upon the county commissioners, who were about to examine his accounts. The treasurer was given a cashier's check for a large sum, which he indorsed and took to the commissioners. They received it, but refused to discharge him or his bondsmen, and placed the check and such funds as he had in cash in a box and delivered them to his bondsmen. The latter deposited the money and the check in another bank in the same place. This last bank, as appeared by the evidence in the case, manifested a desire to get control of this check, with a view to oppress its rival bank which had issued it, and seemed to have a knowledge of how it was issued. The bank brought an action against the bank issuing it to recover the amount. The question of the *bona fide* ownership of this check, and how far the bank holding it was protected as a purchaser for value without notice, was the main one before the court. The United States Supreme Court held that the circumstances under which the check was issued were a plain fraud upon the law, and also upon the county commissioners; that the receipt of it and turning it over to the bondsmen of the county treasurer was a single act intended to assist the bondsmen in protecting themselves, and was inconsistent with the idea of releasing them from their obligations; that the question whether the evidence did or did not establish the fact that the bank in which it was deposited was an innocent holder should have been submitted to the jury.[1]

§ 319. Deposits in savings banks.— A savings bank cannot refuse to return a depositor's money to him because he deposited

National Bank *v.* Valentine, 18 Hun, 417; Manfg. National Bank *v.* Newell, 71 Wis. 309; Buller *v.* Harrison, Cowp. 565.

[1] Thompson *v.* Sioux Falls National Bank, (1893) 150 U. S. 231. As to the vesting of title in a check deposited to the credit of payee and indorsed for deposit, see Ditch *v.* Western Nat. Bank of Baltimore, (Md. 1894) 29 Atl. Rep. 72, where there is a full review of the cases upon this subject. In Security Bank of Minnesota *v.* Northwestern Fuel Co., (Minn. 1894) 59 N. W. Rep. 987, it was held that upon a deposit being made by a customer of a bank, in the ordinary course of business, of checks, drafts or other negotiable paper, received and credited on his account as money, the title to the checks, drafts or other paper immediately becomes the property of the bank, unless a different understanding affirmatively appears. Further, that an indorsement by the customer of a check payable to his own order "for deposit in the [name of the bank] to the credit of [the name of the depositor] is sufficient to pass the title to the check to the bank, and is not a restrictive or qualified indorsement." The court cite in support of its ruling

it in the name of some one else.[1] General depositors of savings banks cannot set off their deposits against their debts due the bank. The rule is different in the case of special deposits out of the ordinary course of business which the bank may have received and converted to its own use.[2] A savings bank in New Jersey, under a special charter, was authorized to receive and invest deposits for the benefit of the depositors, the income or the profit to be divided among them after reasonable deductions for necessary expenses, the principal to be repaid to the depositors at such time and with such interest and under such regulations as the board of managers should from time to time prescribe. Under their regulations they not only received deposits participating in the profits, and not payable except on thirty days' notice, but also another kind of deposits, called by them "special deposits," which were not to participate in the profits, and were to be repaid to the depositors without any preliminary notice. Both kinds of deposits were mingled in the funds of the bank indistinguishably. A receiver was appointed for the bank under insolvency proceedings. The court, as to the relations between the depositors and the bank and the rights of the different claims against the assets, held as follows: That the bank was a mere trustee for the benefit of the depositors; that a depositor who borrowed money from the bank, secured by his note or mortgage, could not set off against his debt the amount of his deposit at the time when the decree of insolvency was made; that the so-styled "special" depositors were not entitled to priority in payment over the other class of depositors; that debts and expenses contracted by the bank in carrying on its ordinary business were to be preferred; that a claim under the covenant in a lease for rent accruing after the surrender of the premises to the lessor by the receiver could not be maintained; that money paid to the bank

Bank *v.* Miller, 77 Ala. 168; Bank *v.* Smith, 132 Mass. 227; Fletcher *v.* Osbourn, (Minn.) 57 N. W. Rep. 336.

[1] Davis *v.* Lenawee County Savings Bank, 53 Mich. 163. As to deposits in savings banks by one in the name of others, see Kimball *v.* Norton, 59 N. H. 1; Blasdel *v.* Locke, 52 N. H. 238; Marcy *v.* Amazeen, 61 N. H. 131; Smith *v.* Ossipee Savings Bank, 64 N. H. 228; Bartlett *v.* Remington, 59 N. H. 364; Giles *v.* Merritt, 59 N. H. 325.

[2] Cogswell *v.* Rockingham Savings Bank, 59 N. H. 43. As to the statements in a savings bank deposit book being a part of the contract between the bank and the depositor, see Heath *v.* Portsmouth Savings Bank, 46 N. H. 78.

in exchange for its check, given for the accommodation of the payee, which was dishonored, presumably went into the funds, and the debt should be preferred; that checks given to depositors on account of deposits were not to be preferred.[1] Money deposited with a savings institution, to be paid at certain times prescribed, may, after demand made in pursuance of the by-laws, be recovered in an action of assumpsit. It would be no defense that the institution, having, in accordance with its by-laws, invested its funds in stocks which have depreciated, was unable to repay the whole amount of the deposits.[2] Reasonable care and diligence is required of the officers of savings institutions.[3] Reasonable care and diligence do not necessarily require the disbursing officer of a savings institution to demand strict proof of the identity of the depositor in paying money on the presentment of a deposit book.[4] A deposit in a savings bank stated in the depositor's "deposit book" not made payable to order or bearer cannot be assigned so as to enable the assignee to maintain an action for the deposit against the bank.[5] A depositor in a savings bank in Pennsylvania drew an order thereon payable nine

[1] Stockton *v.* Mechanics' Bank, 5 Stew. Eq. (N. J.) 163.

[2] Makin *v.* Institution for Savings, 19 Me. 128; Makin *v.* Institution for Savings, 23 Me. 350.

[3] Sullivan *v.* Lewiston Institution for Savings, 56 Me. 507.

[4] Sullivan *v.* Lewiston Institution for Savings, 56 Me. 507. In this case the depositor received a book of deposit containing a copy of the by-laws, which, in accordance with their provisions, he thereupon "subscribed and thereby signified his assent to." These by-laws provided that "all deposits shall be entered in a book to be given the depositor, which shall be his voucher and the evidence of his property in the institution," and that "the money of any depositor may be drawn either personally or by witnessed order, in writing of the depositor, but no money shall be paid to any person without the production of the original book, that such payment may be entered therein," and that "the institution will not be responsible for loss sustained when a depositor has not given notice of his book being stolen or lost, if such book be paid in whole or in part on presentment." Subsequently the depositor's book was stolen, presented to and paid by the disbursing officer of the institution in good faith. In this action of the depositor to recover the deposit it was held that if the disbursing officer, using reasonable care and diligence, but lacking present means of identifying the depositor, paid *bona fide* on presentation of the book by one apparently in the lawful possession of the book, as the owner of it, the institution had a right to rely upon the contract of the depositor safely to keep the evidence of his claim, or make known its loss before it was presented for payment.

[5] Howard *v.* Savings Bank, 40 Vt. 597.

weeks from date. Upon the upper margin of the blank form used were printed the words, "Return notice ticket with this order." On the lower margin below the drawer's signature were the following printed words: "Deposit book must be at bank before money can be paid." The Supreme Court of that state held that there was enough on the face of the order to show that, in the commercial sense, it was not a regular check and was not intended to operate as such, but was drawn on a specially deposited fund, held by the bank subject to certain rules and regulations requiring certain things to be done before payment of the order could be required. "The effect of these requirements," they said, "was to restrain or qualify the otherwise general operation of the order." The court was controlled by the settled doctrine that anything written or printed on a negotiable instrument prior to its issuance by the maker, relating to the subject-matter of the instrument and tending to restrain or qualify it, must be regarded as part of the contract intended to be evidenced thereby.[1]

§ 320. Receiving deposits by a bank knowing its insolvency.— In receiving a deposit, after his insolvency, a banker is guilty of fraud. In such case the depositor will be entitled to rescind the contract and recover the check.[2] The depositor of a check upon another bank with a bank which receives it having knowledge of its insolvency at the time, may, in an action alleging fraud, recover the check or the proceeds thereof.[3] Upon the

[1] Iron City National Bank *v.* McCord, (1891) 139 Pa. St. 52.

[2] American Trust & Sav. Bank *v.* Gueder & Paeschke Manufg. Co., (Ill. 1894) 37 N. E. Rep. 227; Chaffee *v.* Fort, 2 Lans. 81; St. Louis, etc., R. R. Co. *v.* Johnston, 133 U. S. 566.

[3] Grant *v.* Walsh, (N. Y. 1895) 40 N. E. Rep. 209. HAIGHT, J., speaking for the court, said: "The rule appears to be well settled that one who has been induced to part with his property by the fraud of another, under guise of a contract, may upon the discovery of the fraud rescind the contract and reclaim the property, unless it has come into the possession of a *bona fide* holder. In Cragie *v.* Hadley, 99 N. Y. 131; s. c., 1 N. E. Rep. 537, an action was brought by the plaintiff against the receiver of the First National Bank of Buffalo to recover the amount of a draft deposited with the bank at a time when the managers thereof knew that it was insolvent. It was held that permitting the plaintiff to make the deposit in reliance upon the supposed solvency of the bank was a gross fraud upon the plaintiff, and that the latter was entitled to reclaim the draft or its proceeds. The same rule was recognized in Bank *v.* Loyd, 90 N. Y. 530–537, but in that case there was no allegation of fraud in the answer, and consequently it was held that the evi-

discovery of the fraud practiced by a banker in receiving on deposit a check or draft, when he knows that he is insolvent, the depositor may rescind the contract, and reclaim the check or draft deposited, unless such check or draft has come into the possession of a *bona fide* holder for value.[1] If the proceeds of such a check or draft can be traced, the fund will create a trust in favor of the depositor in those proceeds.[2] Should a bank receiving from one of its customers, for deposit, his check upon another bank, knowing its own insolvency at the time, and transfer this check to another bank, in an action by the latter against the drawee of the check, if the drawee answer, by way of defense, that there was fraud practiced upon him by the receiver of the check, and show such fraud, the burden of showing that it was a *bona fide* holder of the check would be upon the bank to which the check was transferred.[3] In a South Dakota case it appeared that the plaintiff had deposited with a bank, a few days before its insolvency was admitted and its doors closed, a sum of money, taking from the bank a receipt, stating the purpose for which the money was left. This purpose was, as shown by the receipt, that when a warranty deed, properly executed, conveying to him certain lands, together with an abstract showing good title in the party who was to execute this deed, was delivered to the bank by the grantor, the money was to be paid to the latter. The bank going into the hands of a receiver, the latter refused to pay the sum of money to the plaintiff upon demand. The Supreme Court affirmed the order of the court in which the proceedings in insolvency were instituted to the receiver to pay this money to the plaintiff on his petition for such order, holding that the sum of money so deposited was a trust fund, and did not become assets of the bank, nor pass to the receiver as such.[1] A depositor in a bank in Nebraska which had

dence offered, tending to show fraud, was properly excluded."

[1] National Citizens' Bank of New York *v.* Howard, (N. Y. Super. Ct. Spl. Term, 1886) 3 How. Pr. (N. S.) 511.

[2] Importers' & Traders' Bank *v.* Everett, (Sup. Ct. 1889) 21 N. Y. St. Repr. 98; s. c., 4 N. Y. Supp. 599; citing Anonymous, 67 N. Y. 598.

[3] Grant *v.* Walsh, (N. Y. 1895) 40 N. E. Rep. 209. HAIGHT, J., speaking for the Court of Appeals, said: "In Bank *v.* Diefendorf, 123 N. Y. 191–206; s. c., 25 N. E. Rep. 402, RUGER, Ch. J., in delivering the opinion of the court, says: 'The burden of making out good faith is always upon the party asserting his title as a *bona fide* holder, in a case where the proof shows that the paper has been fraudulently, feloniously or illegally obtained from its maker or owner. Such a party makes out his title by presumptions, until it is impeached by evidence showing the paper had a fraudulent inception; and when this is done the plaintiff can no longer rest upon the presumptions, but must show affirmatively his good faith.' In Vosburgh *v.* Diefendorf, 119 N. Y. 357–364; s. c., 23 N. E. Rep. 801, O'BRIEN, J., says: 'In this state it must be regarded now as a settled rule that, when a maker of negotiable paper shows that it has been obtained from him by fraud or duress, a subsequent transferee must, before entitled to recover on it, show that he is a *bona fide* purchaser.' In Bank *v.* Green, 43 N. Y. 298, it was held that a party suing upon a negotiable note purchased before maturity is presumed, in the first instance, to be a *bona fide* holder, but when the maker has shown that the note was obtained from him under duress, or that he was defrauded of it, the plaintiff would then be required to show under what circumstances, and for what value, he became the holder. The reason of this rule, as stated by RAPALLO, J., is that 'where there is a fraud the presumption is that he who is guilty will part with the note for the purpose of enabling some third party to recover upon it, and such presumption operates against the holder, and it devolves upon him to show that he gave value for it.' Citing Bank *v.* Noxon, 45 N. Y. 762; Bank *v.* Carll, 55 N. Y. 440; Wilson *v.* Rocke, 58 N. Y. 642; Nickerson *v.* Ruger, 76 N. Y. 279; 2 Greenl. Ev. § 172; Bailey *v.* Bidwell, 13 Mees. & W. 73." As to fraud in receiving deposits by bankers with a knowledge of their insolvency, see Cragie *v.* Hadley, (1885) 99 N. Y. 131; Rochester Printing Co. *v.* Loomis, (1887) 45 Hun, 93.

[1] Kimmel *v.* Dickson, (S. D. 1894) 58 N. W. Rep. 561. There was presented to the court, on behalf of the receiver, an affidavit of the secretary of the bank stating that when it was left with the bank this money "was treated the same as any other deposits of said bank and mixed with the other money therein." It was not intimated that this was done with the knowledge of the one who left the money with the bank for a distinct purpose, or that he in any manner consented to it. The court said: "Upon these facts it would appear that the money was left in trust for a particular purpose. He could not, afterwards, without the acquiescence of [the one who left it] change its relation to him from that of a bailee or trustee to that of a general debtor. We apprehend that no different principle is involved because one of the parties happens to be a bank. Suppose, under the same circumstances, [plaintiff] had left the money with [the secretary] personally, and he had failed and made an assignment, would this money so found in his possession pass to his assignee as his property? If so, when and how did it become due? That he, or the bank in this case, had, without the consent of [the plaintiff] diverted the money and used it for some other purpose, ought not to affect [his] rights. Abuse of a trust can confer no rights on the party abusing it, or on those claiming privity with him. It is not claimed that [cash or money] found in the bank's vault when it failed is the very money or a part of it deposited by [plaintiff], and it is not necessary that it should be so. If the money delivlivered to the bank had been used by it in its business, it had presumably either paid its debts *pro tanto*, or increased its assets; and the general creditors of the bank would be in the same condition if the money found in its possession were paid over in execution of the trust as though the money deposited had been kept separate, and the identical money received had been so paid over. Peak *v.* Ellicott, 30 Kans.

become insolvent and made an assignment, claimed in the courts that, upon his allegations that the bank was insolvent at the time it received the deposit specified, within the knowledge of all of its officers, and that the officers received his money with the intention of cheating and defrauding him, he should be decreed to have a preference on account of his claim in the payment from the funds in the hands of the assignee. The Supreme Court of the state held that he did not have a right to a preference over other creditors upon the case made in his petition.[1] In a late case

156; s. c., 1 Pac. Rep. 499, was a case entirely analogous to this. Peak had left with the bank of which Ellicott, upon its failure, became assignee, money to pay a note which the bank was to send for. As in this case, he took a receipt showing the purpose for which the money was left. The bank passed the amount to the credit of Peak. After the failure of the bank, it not having paid the note, Peak brought action against the assignee, asking the same relief as is asked in this case, to wit, that the assignee be required to pay over the amount in full as a trust fund. The Supreme Court reversed the trial court, holding that the transaction constituted a trust; that the relation created was not that of a debtor and creditor, but that of principal and agent, or bailor and bailee; and that the subject of such trust did not pass to the assignee as assets of the bank. It was held, further, that the manner in which the bank had treated the fund by crediting it to Peak and mixing it with its own money did not affect his right to claim the amount from the funds on hand. Ellicott *v.* Barnes, 31 Kans. 170; s. c., 1 Pac. Rep. 767, was a similar case and the same rule controlled. McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173, 214, applies the same principles, with the same result, where a draft had been left for collection with a banker, who afterwards, and before the depositor had received its proceeds, suspended and assigned. The court held that the proceeds of the draft constituted a trust fund, which did not pass to the assignee, and there not being sufficient cash in the hands of the assignee to pay the amount, that the same should be a lien upon the assigned estate. The same principle, though to somewhat different facts, was applied in People *v.* City Bank of Rochester, 96 N. Y. 32, and again in People *v.* Bank of Dansville, 39 Hun, 187."

[1] Wilson *v.* Coburn, (1892) 35 Neb. 530. The court said: "The rule on the subject is stated by Judge STORY thus: 'The right to follow the trust fund ceases only where means of ascertainment fail, which, of course, is the case when the subject-matter is turned into money and mixed and confounded in a general mass of property of the same description.' Story's Eq. 1259. That the foregoing rule is applicable to cases like this, where the funds in controversy are the assets of an insolvent bank, is well settled. In Ill. Trust & Savings Bank *v.* Smith, 21 Blatchf. 275, Judge WALLACE, after remarking that the property comes into the hands of the receiver as a trust fund for the benefit of all the creditors, proceeds as follows: 'It would be a violation of law upon his part to set aside any part of their assets for the complainant unless his portion is capable of identification or being definitely traced and distinguished,' etc. Counsel for plaintiff in error rely with confidence upon the case of Cragie *v.* Hadley, 99 N. Y. 131. We do not, however, regard that case as authority. That was an action against the defendants for the proceeds of a draft received for collection from an insolvent bank. The fund, therefore, was easily distinguishable from the other assets of the bank. It is evident from subsequent cases in New York that that case has never been regarded as an authority in cases like this, where the money of the claimant has been mingled with the other funds of the bank, and cannot be distinguished from other assets in the hands of the assignee or receiver. In re N. River Bank, 14 N. Y. Supp. 261, is a case directly in point. The Supreme Court therein, after showing that Cragie *v.* Hadley was not authority, for the reason given above, hold that the petitioner was not entitled to preference, although he deposited his money on the forenoon of the day on which the bank closed its doors, on the assurance that it was solvent, upon the ground that it did not appear that the money had not gone into the general funds of the bank, and because he had failed to impress upon the funds in the hands of the receiver the character of a trust. In Atkinson *v.* Rochester Printing Co., 114 N. Y. 168, the same distinction is made, and the court says: 'The fact that the defendant became a creditor of the insolvent bank through the fraud of its officers, and the bank, a trustee *ex maleficio*, gave the defendant no right to a preference over other creditors unless it could trace and recover its property.' And such is the law as recognized from the earliest history by the courts of chancery. Ryall *v.* Rolle, 1 Atkyns, 172; Thompson's Appeal, 22 Pa. St. 16; Perry on Trusts, § 128."

in the federal court for the district of Indiana, it has been held that where money and checks were unsuspectingly deposited in a bank, which was known by its managing officer to be hopelessly insolvent, a few minutes before closing time on the last day on which it did business, and the checks were subsequently collected by the bank's clerk, the whole of the deposit was charged with a trust, and an equal amount might be recovered from the receiver, who retained the specific money among the general mass of the bank's funds.[1] It was insisted in this case, on behalf of the receiver of

[1] Wasson *v.* Hawkins, (1894) 59 Fed. Rep. 233. *Arguendo*, it was said by BAKER, D. J.: "The bank was insolvent, and was known by its president, who had sole management of it, to be insolvent. The knowledge of the president was the knowledge of the bank. Martin *v.* Webb, 110 U. S. 7; s. c., 3 Sup. Ct. Rep. 428; Bank *v.* Walker, 130 U. S. 267; s. c., 9 Sup. Ct. Rep. 519. It fraudulently concealed its insolvency from the complainant, who was ignorant of it, and, believing it to be solvent, he deposited in the bank bank notes and checks to [a certain] amount within five minutes of its final collapse. The reception of the money and checks, under such circumstances, was a fraud upon the plaintiff, and entitled him to rescind the transaction, and recover back his deposit from the bank. The keeping of the bank open, and the conducting of its business in the usual manner, constituted a representation to its customers of the solvency of the bank, upon which they had the right to rely;

the bank, that, though the money and checks were obtained by fraud, the title to them vested in the bank; and that the only relation subsisting between the plaintiff depositor and the bank was that of creditor and debtor; and that he could not reclaim the money and checks, because money has no mark and cannot be identified; and that the plaintiff had no lien on the funds in the receiver's hands entitling him to priority or preference over the other creditors of the bank. The court held adversely to this contention; that the depositor was entitled to be preferred out of the funds in the hands of the receiver.[1]

and if the bank was known to be insolvent by the officers who were charged with its management, the concealment of that fact from a person about to make a deposit would constitute a fraud upon him. The title acquired by the bank to the money and checks deposited under such circumstances would be voidable at the election of the depositor, who could bring suit to recover his deposit, without any previous demand. The bank would become a trustee *ex maleficio*, and would hold the deposit for the use of the depositor, and subject to his right of reclamation. Railway Co. *v.* Johnston, 133 U. S. 566; s. c., 10 Sup. Ct. Rep. 390; Cragie *v.* Hadley, 99 N. Y. Rep. 131; s. c., 1 N. E. Rep. 537; City of Somerville *v.* Beal, 49 Fed. Rep. 790; Peck *v.* Bank, 43 Fed. Rep. 357. In the case of Cragie *v.* Hadley, *supra*, it was held that the acceptance of the deposit by a bank hopelessly insolvent constituted such a fraud as entitled the depositor to his drafts or their proceeds. In Anonymous Case, 67 N. Y. 598, the court say: 'This is not like the case of a trader who has become embarrassed and insolvent, and yet has reasonable hopes that by continuing in business he may retrieve his fortunes. In such a case he may buy goods on credit, making no false representations, without the necessary imputation of dishonesty. Nichols *v.* Pinner, 18 N. Y. 295; Brown *v.* Montgomery, 20 N. Y. 287; Johnson *v.* Monell, 2 Keyes, 655; Chaffee *v.* Fort, 2 Lans. 81. But it is believed that no case can be found in the books holding that a trader who was hopelessly insolvent and knew that he could not pay his debts, and that he must fail in business, and thus disappoint his creditors, could honestly take advantage of a credit induced by his apparent prosperity, and thus obtain property which he had every reason to believe he could never pay for.' And it was decided that 'in the case of bankers, where greater confidence is asked and reposed, and where dishonest dealings may cause widespread disaster, a more rigid responsibility for good faith and honest dealing will be enforced than in the case of merchants and other traders;' and that 'a banker who is, to his own knowledge, hopelessly insolvent, cannot honestly continue his business and receive the money of his customers; and, although having no actual intent to cheat and defraud a particular customer, he will be held to have intended the inevitable consequences of his act, *i. e.*, to cheat and defraud all persons whose money he receives, and whom he fails to pay before he is compelled to stop business.'"

[1] Wasson *v.* Hawkins, (1894) 59 Fed. Rep. 233. The discussion by the court of the question thus raised deals very

§ 321. Certificates of deposit.—In making the discount of a note, a bank may give a certificate of deposit for the proceeds, instead of paying over the money to the borrower.[1] Where one person intrusts money to another to deposit in bank, the bank having knowledge of the ownership, but no discretion as to the

fully with English as well as other authorities, and was in these words: "It was said by Lord KING in Deg *v.* Deg, 2 P. Wms. 414, 'that money had no earmark, inasmuch that if a receiver of rents should lay out all the money in the purchase of land, or if an executor should realize all his testator's estate, and afterwards die insolvent, yet, a court of equity could not charge or follow the land.'" See, also, Cox *v.* Bateman, 2 Ves. Sr. 19. And bank notes and negotiable bills have been represented as possessing the same quality. But the notion that money, because it had no earmark, could not be followed into or charged upon land in the hands of the trustee or his executor, arose from some misconception, and could not be supported. In Miller *v.* Race, 1 Burrows, *452, Lord MANSFIELD exposed this misconception, and pointed out the true reason why money could only be pursued under particular circumstances. He observed: "It has been quaintly said that the reason why money cannot be followed is because it has no earmark; but this is not true. The true reason is upon the currency of it; it cannot be recovered after it has passed in currency. So, in case of money stolen, the true owner cannot recover it after it has been paid away fairly and honestly upon a valuable and *bona fide* consideration; but, before money has passed in currency, an action may be brought for the money itself. Apply this to the case of a bank note. An action may lie against the finder, it is true, and it is not at all denied, but not after it has been paid away in currency; and this point has been determined even in the infancy of bank notes." Lord ELLENBOROUGH, in Taylor *v.* Plumer, 3 Maule & S. 562, 575, observed: "The dictum that money has no earmark must be understood as predicated only on an undivided and undistinguishable mass of current money; but money kept in a bag, or otherwise kept apart from other money, guineas, or other coin marked (if the fact were so) for the purpose of being distinguished are so far earmarked as to fall within the rule which applies to every other description of personal property while it remains in the hands of the factor or his general legal representative." After these references to English cases, it was said: "The true distinction, therefore, between money, bank notes or negotiable bills, and other chattels, would seem to be that the former, for the protection of commerce, cannot be followed into the hands of a *bona fide* holder to whom they have passed in due course of business, while other chattels affected by a trust may, in general, be pursued and reclaimed. The ancient notion that money could not be followed, even as between trustee and *cestui que trust*, because money had no earmark, has given way to a more just and enlightened doctrine. Money, bank notes and negotiable bills may be followed by the rightful owner, where they have not been circulated or negotiated, or if the person to whom they have passed has express notice of the trust. Miller *v.* Race, 1 Burrows, *452; 1 Smith Lead.

[1] Mississippi Railroad Co. *v.* Scott, 7 How. (Miss.) 79.

manner of making the deposit, it will be warranted in receiving the money and giving a certificate of deposit therefor in the name of the person presenting the money for deposit. And where the real owner of the money deposited, receiving notice of the manner in which it was deposited, fails to dissent thereto within a

Cas. (5th Amer. ed.) 597 (*250); Taylor *v.* Plumer, 3 Maule & S. 562, 575; King *v.* Egginton, 1 Term R. 370; Ryall *v.* Rolle, 1 Atk. 172; Pennell *v.* Deffell, 4 DeGex, M. & G. 372; In re Hallett's Estate, 36 Eng. R. 779; s. c., 13 Ch. Div. 696; National Bank *v.* Insurance Co., 104 U. S. 54. The only difference between money and notes and bills, is that money is not earmarked, and, therefore, cannot be traced, except under particular circumstances, while bills and notes, having a number and date, may generally be identified with less difficulty. It is conceded that, if plaintiff could identify the particular coins and bank notes which he had deposited, he would have the right to withdraw them from the mass of coins and bank notes which passed into the hands of the receiver; but it is insisted that inasmuch as the money deposited by him has, like water, flowed into the common mass and so become incapable of identification, the right to pursue and reclaim it is lost, although it is admitted that the very coins and bank notes deposited by him constitute a part of the common mass. It is charged in the bill, and admitted by the demurrer, that the identical coins and bank notes deposited by the plaintiff remained in the bank when it stopped business, and came into the hands of the receiver, who now has them in his possession as a part of the general mass of coins and notes held by him as such receiver. In such a case the identification is sufficient to entitle the depositor to follow and reclaim the deposit made by him. Although the identical coins and bank notes cannot be ascertained, yet, as it is admitted that so much in coins and bank notes belonging to the plaintiff is in common mass, he is entitled, in equity and good conscience, to take so much out. If he does not withdraw from the common mass the very coins and bank notes deposited by himself, no injustice is done, for he leaves an equitable amount of his own in place of every coin or bank note deposited by another. Pennell *v.* Deffell, 4 DeGex, M. & G. 372; In re Hallett's Estate, 36 Eng. R. 779; s. c., 13 Ch. Div. 696; Cragie *v.* Hadley, 99 N. Y. 131; s. c., 1 N. E. Rep. 537; National Bank *v.* Insurance Co., 104 U. S. 54; Frelinghuysen *v.* Nugent, 36 Fed. Rep. 229; Peters *v.* Bain, 133 U. S. 670; s. c., 10 Sup. Ct. Rep. 354; Bank *v.* Dowd, 38 Fed. Rep. 172; Atkinson *v.* Printing Co., 114 N. Y. 168; s. c., 21 N. E. Rep. 178; In re North River Bank, 14 N. Y. Supp. 261. And the proceeds of the checks are governed by the same principle, because the identical coins and bank notes realized from their collection constitute a part of the common mass in the receiver's hands. The mere fact that the plaintiff became a creditor of the insolvent bank through the fraud of its president, and that the bank became a trustee *ex maleficio*, would give him no right to preference over other creditors, unless he can trace and identify his money as a part of the common mass. But when it is shown by indubitable proofs, or is admitted, as in the present case, that the identical bank notes and coins so obtained by fraud, constitute a part of the common mass of bank notes and coins

reasonable time, he will be held to have ratified the same. And after the lapse of several years he cannot object that the bank subsequently paid over the money to his agent upon the presentation of the certificate of deposit, the bank having no knowledge that the agent's possession of the certificate was wrongful and tortious.[1] A certificate of deposit is *prima facie* evidence of indebtedness.[2] A certificate of deposit payable in "currency" means *prima facie* money current by law, or paper equivalent in value circulating in the business community at par.[3] By giving a certificate of deposit for current bank notes," the receiver of the deposit admits that to be the character of the money received, and will be estopped by the admission from showing that the funds received were not current, or claiming the right to pay in anything but the same character of funds.[4] A certificate of deposit has been treated, in fact and in law, as a promissory note for the payment of money.[5] A certificate of deposit for a stated sum, to draw interest, if left for thirty days, and payable on return of the certificate properly indorsed, has

in the hands of the receiver, in my judgment, the modern and better doctrine is that the depositor may take out of the common mass so much as he has put in."

[1] Bank of Montreal *v.* Dewar, (1880) 6 Bradw. (Ill.) 294. On the first point the court cited McNeil *v.* Tenth National Bank, 46 N. Y. 325; Anderson *v.* Armstead, 69 Ill. 452.

[2] Cushman *v.* Illinois Starch Co., 79 Ill. 281.

[3] Phelps *v.* Town, 14 Mich. 374. In Hulbert *v.* Carver, (1863) 40 Barb. 265, where the plaintiffs had deposited money with defendants, bankers in Chicago, Illinois, taking a certificate that they had deposited in the bankers' office a certain amount "Illinois currency," payable to the order of themselves on return of the certificate, the Supreme Court of New York held that they were at least entitled to payment in Illinois currency, receivable in the ordinary transactions of business at par, if not entitled to specie.

[4] Osgood *v.* McConnell, (1863) 32 Ill. 74. As to the meaning of "currency" and "current bank bills" the court said: "This court has repeatedly held that currency and current bank bills have a fixed known signification. That the term currency means bank bills or other paper money, which passes as a circulating medium in the business community as and for the constitutional coin of the country. Current bank bills, it will be perceived, mean precisely the same thing as currency. This question has been repeatedly before the court, and it has been uniformly so held. See Chicago Fire & Marine Ins. Co. *v.* Keiron, 27 Ill. 501; Marine Bank *v.* Chandler, 27 Ill. 525; Galena Ins. Co. *v.* Kupfer, 28 Ill. 332; Chicago Marine & Fire Ins. Co. *v.* Carpenter, 28 Ill. 360; Marine Bank *v.* Rushmore, 28 Ill. 463; Swift *v.* Whitney, 20 Ill. 144; Trowbridge *v.* Seaman, 21 Ill. 101."

[5] Bank of Peru *v.* Farnsworth, 18 Ill. 563; Laughlin *v.* Marshall, 19 Ill. 390.

been held to be a good promissory note.[1] Where a bank addresses to another bank an instrument stating that a person had deposited with it a stated sum of money to the credit of the latter bank for the use of a third person, such instrument would be in its legal character a certificate of deposit.[2] A certificate of deposit, "payable in current funds," is equivalent to a promissory note, but not being payable in money is not governed by law merchant.[3] Indorsees of a certificate of deposit, not bearing interest, who received it more than six years after it had been paid and should have been surrendered, were held by the Indiana Supreme Court to have taken it as dishonored paper, and not as a continuing negotiable security, and not entitled to enforce its second payment after such an unreasonable delay.[4] The transferree by indorsement of a certificate of deposit, takes it subject to all equities between the payee and the bank.[5] In a case where a national bank upon a deposit made by a depositor over its counter, in the usual course of business, issued to him a certificate of deposit, which he received in the belief that it was the obligation of the bank, but which purported to be the individual obligation of its president, the officers of the bank knowing of and permitting this course of business, the Supreme Court of New York held that the defendant was not bound by the acceptance of the certificate to knowledge or notice that the deposit was accepted by the president of the bank individually, but was entitled, under the circumstances, to believe the certificate was the obligation of the bank, and that the bank was estopped to deny its liability on the certificate.[6] A bank has been held responsible for the money of a depositor notwithstanding a fraud perpetrated by its officers in inducing the depositor to accept their certificate of deposit as that of the bank.[7] But a bank would not be responsible for an

[1] Howe *v.* Hartness, (1860) 11 Ohio St. 449.

[2] Armstrong *v.* American Exchange National Bank, 133 U. S. 433.

[3] National State Bank of La Fayette *v.* Ringel, (1875) 51 Ind. 393.

[4] Gregg *v.* Union County National Bank, (1882) 87 Ind. 238. As to the regularity of certificates of deposit, see O'Neill *v.* Bradford, 1 Pinn. (Wis.) 390; Ford *v.* Mitchell, 15 Wis. 304; Platt *v.* Sauk County Bank, 17 Wis. 222; Lindsey *v.* McClelland, 18 Wis. 481; Klauber *v.* Biggerstaff, 47 Wis. 551.

[5] Humboldt Trust Co.'s Estate, 3 Pa. Co. Ct. Rep. 621.

[6] West *v.* First National Bank of Elmira, (1880) 20 Hun, 408. As to negotiability of a certificate of deposit, see Smith *v.* Mosby, Receiver, (1872) 9 Heisk. (Tenn.) 501.

[7] Steckel *v.* Bank, 93 Pa. St. 376; Ziegler *v.* Bank, 93 Pa. St. 393.

interest-bearing certificate of deposit, issued by its president in the name of his firm, under circumstances by which the depositor could not have been misled.[1] In an Illinois case it appeared that the employee of owner of money, who had intrusted it to him to deposit for him in a bank, deposited it in his own name, the bank knowing whose money it was at the time. The employee afterward indorsed the certificate of deposit to the owner of the money, who deposited the certificate in the safe to which his employer had access, but gave no notice of these facts to the bank until after the employer had taken the certificate, and drawn the money on it, and had it placed to his own individual account, when he did inform the bank of his rights. After this, however, he treated the transaction as a loan to his employee for over three years, expecting to have him secure it. During this time he made no claim on the bank. The Supreme Court held that under these facts the owner of the money thus deposited could not maintain an action of trover against the bank for a conversion of the money, for the reason that he had by his acts vested his employee with an apparent ownership or control of the money, and had thus acquiesced in the payment of the money to him.[2] The assigning of a certificate of deposit transfers to the assignee the whole sum deposited, as stated in the certificate.[3] An innocent holder of a certificate of deposit issued to a cashier, naming him, for funds deposited belonging to his bank which the cashier transferred to him, would be protected, though the transfer may be in bad faith on the part of the cashier.[4] An attempt by the holder of a certificate of deposit to obtain payment of it before

[1] Bank *v.* Williams, 11 W. N. C. (Pa.) 347. In Jenkins *v.* Walter, 8 G. & J. (Md.) 218, a guardian had deposited money of his ward in a bank and received a certificate of deposit payable to his own order. On the day of deposit, by an indorsement on the certificate made to himself, he declared it to be the property of his ward, and placed in bank for his benefit. The depositor subsequently failed. The court held that the bank might apply the fund in satisfaction of any claim it had against the depositor.

[2] Dewar *v.* Bank of Montreal, 115 Ill. 22.

[3] Springfield Marine & Fire Ins. Co. *v.* Peck, (1882) 102 Ill. 265. In Hazleton *v.* Bank of Columbus, 32 Wis. 34, a bank which had paid its certificate of deposit to one to whom it had been properly indorsed, though without consideration as to one who really owned it and the money, and the indorsement was forged, it was held, would not be liable on the certificate to the original payee.

[4] Perpetual Ins. Co. *v.* Cohen, (1845) 9 Mo. 421. In Philipps *v.* Franciscus, (1873) 52 Mo. 370, where one owing money to another took the amount, and, after placing it in an en-

it falls due, is not inconsistent with its ownership by some one else.[1] The *bona fide* holder of a certificate of deposit issued by a bank payable on its return, properly indorsed, to whom it was transferred seven years after its issue, has been held entitled to recover the amount from the bank, notwithstanding the bank had paid it to the original holder.[2] The holder of a non-negotiable certificate of deposit, which has been indorsed to him in blank by the payee and delivered to him, may make a valid pledge of it to an innocent party, without reference to the equities between himself and the payee.[3] On demand of payment of a certificate of deposit in a savings institution payable to the depositor or order, on demand and on return thereof, the bank has the right to insist that the certificate shall be produced and delivered up as its voucher of payment, and security against any future claim.[4] In a Vermont case it appeared that an insolvent person fraudulently procured a certification of a check from a bank, which he deposited in a second bank to the credit of a third bank for the use of one to whom he was indebted to that amount. The creditor of the insolvent had previously directed the latter to deposit that sum for him in bank, but had no communication with the second bank, above referred to, on the subject. The bank, on receiving the deposit, had addressed a letter to the third bank, informing them of the deposit and credit, but, before this bank received the letter, notified them by telegraph by procurement of the bank certifying the check, not to make payment to the creditor upon this credit, as there was something wrong. The creditor was also

velope, sealed the package and placed it in the hands of a banker and took a certificate of deposit of the same, which he indorsed and delivered to his creditor, the title of the latter to the money was held to be complete. In Second National Bank of Baltimore *v.* Wrightson, Exr., (1884) 63 Md. 81, it appeared that the appellee's testator had deposited a sum of money in the bank and received a certificate of deposit stating that the same was payable to the order of himself or of his wife (naming her) on the return of the certificate. The Court of Appeals held that upon the death of the depositor a payment of the certificate to the wife was not authorized, but that the bank was entitled to a credit for the amount which she had drawn and applied to the use of his estate in the way of personal expenses, etc. Citing Murray *v.* Cannon, Admr., 41 Md. 466; Taylor *v.* Henry & Bruscup, Admrs., 48 Md. 550.

[1] Burrows *v.* Bangs, 34 Mich. 304.

[2] National Bank of Fort Edward *v.* Washington County National Bank, (1875) 5 Hun, 605.

[3] International Bank *v.* German Bank, (1879) 71 Mo. 183.

[4] Fells Point Savings Inst. of Baltimore *v.* Weedon, Admr., 18 Md. 320.

informed by telegraph by his debtor, the insolvent, the drawer of the check, that payment of the credit had been stopped. These telegrams were received as early at least as the creditor received notice of the deposit, and before he had in any way acted upon it. The certifying bank, before becoming fully informed of the fraud, had paid the money on the check to the second bank. On the bill in chancery brought by the certifying bank, the Supreme Court held that it was entitled to reclaim the money from the bank to which it had paid it; that the receipt of the money by that bank was not in law a payment to the creditor, considering the relations between all the parties growing out of this transaction.[1] The right of action upon an ordinary certificate of deposit does not arise until a demand for payment is made.[2] Limitations on a certificate of deposit payable with interest on demand and on return of same, run along from the time of demand actually made.[3] The defendant in this New York case, a director of a national bank, had deposited a certain amount of money in the bank, and received three certificates of deposit, two at one time and one at another, bearing six per cent interest. The two certificates first issued, the cashier, in a little more than three years after their issue, voluntarily paid by a transfer of negotiable paper belonging to the bank, and the payment of a small cash difference, giving as a reason therefor "that his directors did not like his paying so large a rate of interest;" the payment was not requested by the depositor. Near nine months later the third certificate, which had been indorsed and transferred by the depositor to another national bank, was paid to the bank in the settlement of exchanges between the banks in the usual manner. At the time of the payment the bank was insolvent, and had been so for some years, its insolvency being known only to the cashier, and it was in good credit with the public,

[1] Bank of Republic *v.* Baxter, 31 Vt. 101. In Cate *v.* Patterson, 25 Mich. 191, the payee of a certificate of deposit had transferred it with a special request that it should not be presented until three months had expired, and had actually received from the purchaser the interest accrued at the date of the transfer. The purchaser presented the certificate after the time expired and the bank had in the meanwhile failed. In an action against the payee as indorser, he was held not to have been relieved from liability on the ground that the presentment for payment was not in due time.

[2] Munger *v.* Albany City National Bank, (1881) 85 N. Y. 580.

[3] Fells Point Savings Inst. of Baltimore *v.* Weedon, Admr., etc., 18 Md. 320.

doing business without suspicion. Its financial condition shortly after the payment of the third certificate of deposit became public from the absconding of the cashier and one of the bookkeepers. The receiver of the bank, afterwards appointed, brought this action against the former depositor to recover the amount of the deposits paid him, upon the ground that the payments were void under the section of United States Revised Statutes cited below,[1] which provides as follows: "All transfers of the notes, bonds, bills of exchange or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void." The New York Court of Appeals affirmed the dismissal of this action upon the findings of fact and evidence by the trial court, which had also been affirmed by the General Term.[2] In a case it appeared

[1] § 5242.

[2] Hayes *v.* Beardsley, (1892) 136 N. Y. 299. EARL, Ch. J., in the opinion, said: "The bank had not committed any act of insolvency, as it met all its obligations as they became due or were demanded during more than six weeks after the last certificate was paid. While its cashier knew that the bank was insolvent, and must have expected that it would ultimately fail to meet its obligations and be obliged to go into liquidation, yet it cannot be said to have been an undisputed fact in the case that the financial collapse of the bank was impending or imminent, and there is little if any ground for saying that these payments were made in contemplation of insolvency. The cashier paid the certificates, as he did all other demands upon the bank as they were from time to time presented by its numerous customers. The first two certificates were paid, as we must assume, for the reason assigned by the cashier at the time, because they were bearing interest at a larger rate than the directors of the bank were willing longer to pay, and the last certificate was paid to the [bank holding it] in the ordinary course of business in the settlement of exchanges between the two banks. There was no satisfactory evidence that these payments were made by the bank to prevent the application of its assets in the manner prescribed in the National Banking Act or with a view to a preference of the defendant over the other creditors of the bank. The circumstances under which the payments were made and the condition and credit of the bank at the time forbid the inference that the payments were made for such a purpose. The defendant was not selected as a favorite creditor. During all the years of the insolvency of the bank all creditors were treated alike, and there was no preference of one over another. All its demands were met at maturity. There does not appear from the facts found to be any better ground for claiming that these payments made to the defendant were void than there is for making the same claim in reference to the numerous payments made in the regular course of business by this bank to its customers during many months prior to the closing of its doors. In order to uphold a recovery in an action like this there should be some satisfactory evidence that the cashier or other officer actually paid the money of the bank in contemplation of insolvency for the purpose of giving a preference to the payee and with a view to prevent the application of the assets of the bank to the creditors generally, as provided in the National Banking Act. We think all the circumstances surrounding these deposits and payments forbid such an inference." As to the effect of the defendant being a director it was said: "The insolvency of this bank seems to have been covered up and concealed by the cashier with great skill and ingenuity. It was not discovered by the bank examiners in making their examinations of the bank, and no one of the directors had the least suspicion of it. The fact that the defendant, entirely ignorant of the insolvency of the bank, was a director does not, under such circumstances, as a matter of law, charge him with liability for the payment made to him. In the trial of the case and in weighing and balancing the evidence that fact might have weight — in some cases controlling weight — with the trial court. But when, after all the evidence is given, it is found that the director acted in good faith, was ignorant of any wrongdoing or of the insolvency of the bank, then a payment made to him must be tested under section 5242 [U. S. Rev. St.] like payments made to any other creditor of the bank."

that two persons who were directors both of a savings bank and of a national bank, procured money from the savings bank on two notes made by third persons to them, and given for the payment of stock of the national bank, issued in the names of the third persons for their benefit. These persons represented to the savings bank that it would have to carry the notes but a short time, and that the national bank would take care of them. They were behind in their account with the national bank, and the savings bank allowed them to overdraw their accounts with it to a large amount, which money was used in settling their accounts with the national bank. After this the savings bank delivered the notes and the check representing the overdrafts to the national bank, and received from the latter a certificate of deposit for an amount covering the whole amount represented by the notes and check. In a suit by the receiver of the savings bank, which had become insolvent, against the receiver of the national bank,

also insolvent, based upon this certificate of deposit, it was held that the certificate of deposit was without consideration and void, and that the savings bank would have to submit to the loss accruing to it out of the transaction, as the loss was due to the fraud or incompetency of its own officers.[1]

§ 322. **Special deposits.**— The United States Supreme Court has held that the provision of the National Banking Association Act, that it shall be lawful for a national bank after its failure to "deliver special deposits," was as effectual a recognition of the power of a national bank to receive special deposits as an express declaration to that effect would have been.[2] Bank notes, when received by a bank on general deposit, become the property of the bank, and the amount a debt payable on demand by the bank to the person entitled to it. An action of debt or assumpsit against the bank is the only remedy of the creditor in case payment be refused. But it is different if they be deposited as a special deposit. The deposit then is nothing but a bailment. And if a cashier of the bank converts them it is a tortious act for which he will be held individually liable in an action of trover.[3] A deposit in bank will not be made a special one nor will the liability of the bank be changed by the addition of the word "clerk" to the name of a general depositor.[4] Where a bank has given a receipt for money received "on deposit," such a receipt would not show whether it was a special or general deposit, and the bank would be allowed to show by parol evidence that the transaction was in fact a special deposit.[5] In cases of special deposit the right of property remains in the depositor, and he is entitled to receive back the identical thing deposited.[6] A bank, in receiving a special deposit, undertakes to exercise no greater care in its preservation than the depositor has the reasonable right

[1] Murray *v.* Pauly, (1893) 56 Fed. Rep. 962.

[2] National Bank *v.* Graham, (1879) 100 U. S. 699, which overruled Whitney *v.* National Bank of Brattleboro, 50 Vt. 388.

[3] Coffin *v.* Anderson, (1837) 4 Blackf. (Ind.) 395.

[4] McLain *v.* Wallace, (1885) 103 Ind. 562. Distinction between special and general deposits, McLain *v.* Wallace, (1885) 103 Ind. 562; Keene *v.* Collier, 1 Metc. (Ky.) 417. As to a special deposit of bonds, see Van Leuven *v.* First National Bank of Kingston, (1873) 54 N. Y. 671.

[5] Keen *v.* Beekman, 66 Iowa, 672.

[6] Lowry *v.* Polk County, 51 Iowa, 50. As to a bank's liability to return a special deposit in kind, see Chesapeake Bank *v.* Swain, 29 Md. 483.

to suppose is exercised in caring for its own property of like description.[1] A bank, receiving a package of money as a special deposit without compensation, will be bound only for slight care, and responsible only for gross negligence.[2] The obligation of a banker in the keeping of a deposit will not be increased by a mere showing to the depositor the facilities and securities of the bank.[3] A bank will be liable where special deposits are lost by reason of gross negligence or willful inattention on the part of its directors.[4] In case a special deposit of bonds, stock or coin with a bank be stolen or embezzled by its clerk or cashier and he does not participate in the act and is guilty of no negligence in the matter, the bank will not be responsible to the depositor for its value.[5] A national bank will be held liable for damages occasioned by the loss, through negligence, of a special deposit made in it with the knowledge and acquiescence of its officers and directors.[6] Robbery by burglars of securities deposited for safe-keeping in the vaults of a bank would be no proof of negligence on the part of the bank in caring for the property.[7] In a Vermont case, one depositing with the cashier of a national bank $4,000 of United States bonds, received this writing: "Received of J. D. Whitney four thousand dollars for safe-keeping as a special deposit." [Signed] "S. M. Waite, C." This appearing to be a naked deposit without reward, the Supreme Court of that state held that the word "safe-keeping" only indicated the purpose for which the bonds were delivered and received, and did not import a contract to keep safely; that the bank was answerable only for fraud or gross negligence in the keeping of the bonds, and was not liable for the

[1] United Society of Shakers *v.* Underwood, (1873) 9 Bush (Ky.), 616.

[2] Hale *v.* Rawallie, (1871) 8 Kans. 136.

[3] Ibid. An illustration of a bank being rendered liable to a depositor as trustee for a breach of trust in connection with its application of the avails of a special deposit for the benefit of depositor's agent, Manhattan Bank *v.* Walker, 130 U. S. 267. In Leach *v.* Hale, 31 Iowa, 69, United States bonds were deposited with a bank for the purpose of their being converted into similar bonds of another denomination. The Supreme Court held that the transaction should be deemed one for a compensation and not a gratuitous one, and that the bank was liable as a bailee for hire.

[4] United Society of Shakers *v.* Underwood, (1873) 9 Bush, 616. As to the care with which a bank must keep a special deposit, see Boyden *v.* Bank of Cape Fear, 65 N. C. 13.

[5] Sturges *v.* Keith, (1870) 57 Ill. 451.

[6] National Bank *v.* Graham, (1879) 100 U. S. 699.

[7] Wylie *v.* Northampton Bank, 119 U. S. 361.

loss by robbery or larceny, if the bank acted in good faith and took the same care of these bonds as it did of its own of like character.[1] By a cashier wrongfully transferring a special deposit and putting it with the funds of the bank, and the bank reporting and treating it as a part of its assets, a conversion of the deposit is effected, and no demand and refusal would be necessary for the depositor to maintain an action of trover against the bank.[2] Where a bank receiving a special deposit had transferred it to another bank established at the same place, with the same officers, and the deposit was embezzled by the cashier, the Kentucky Court of Appeals held that the bank receiving the deposit would be liable unless the depositor directly or by implication assented to or ratified the transfer prior to the loss.[3]

§ 323. The duty of a bank as to deposits and its right as to their application.— A deposit received under special agreement must be applied by the bank according to the agreement.[4] A depositor with a bank who, having made overdrafts, should transfer securities to the bank, and request that these overdrafts be paid, would thereby create a valid trust for the payment of such outstanding checks and drafts, whether presented or not, and the holders of such checks and drafts would be entitled to payment out of the securities so deposited in preference to the general creditors of the depositor.[5] Where a depositor of a bank

[1] Whitney *v.* National Bank of Brattleboro, 55 Vt. 154. As to the liability of a bank receiving special deposits where loss is the result of their gross negligence, see Foster *v.* Essex Bank, 17 Mass. 479; Lancaster County National Bank *v.* Smith, 62 Pa. St. 47; Scott *v.* National Bank of Chester Valley, 72 Pa. St. 471; First National Bank of Carlisle *v.* Graham, 79 Pa. St. 106; Turner *v.* First National Bank of Keokuk, 26 Iowa, 562; Smith *v.* First National Bank in Westfield, 99 Mass. 605; Chattahoochee National Bank *v.* Schley, 58 Ga. 369.

[2] First National Bank of Monmouth *v.* Dunbar, 19 Bradw. (Ill.) 558.

[3] Ray *v.* Bank of Kentucky, (1874) 10 Bush (Ky.), 350. That a bank is not liable in case its cashier fraudulently takes away a special deposit made in the bank, see Foster *v.* Essex Bank, (1821) 17 Mass. 479; Smith *v.* Westfield Bank, (1868) 99 Mass. 605.

[4] Wilson *v.* Dawson, (1876) 52 Ind. 513, in which case the surety of a depositor for debts due at the bank, where the depositor had deposited more than sufficient to pay those debts, but under special agreement that these deposits were to be paid out on checks for certain purposes, some of which deposits was in bank when the debts matured, and paid out under the agreement, was held not released, though ignorant of the special agreement with the depositor.

[5] Watts *v.* Shipman, (1880) 21 Hun, 598.

is indebted to the bank by bill, note or other independent indebtedness, the bank has the right to apply so much of the funds of the depositor to the payment of his matured indebtedness as may be necessary to satisfy the same.[1] And the same rule obtains where a depositor makes his paper to third persons payable at the bank. As it is the duty of the bank to pay its customers' checks, when in funds, so at least it has authority, if it is not under actual obligation, to pay his notes and acceptances made payable at the bank. It is a presumption of law that if a customer does so make payable or negotiable at a bank any of his paper, it is his intent to have the same discharged by his deposit.[2] The Supreme Court of Illinois has held that the order of a depositor to his bank to apply his funds deposited to the payment of a note of his payable at the bank is necessary to give the bank power to pay the note.[3] Verbal direction, or a check or draft or some other writing signed by a depositor to a bank in which he has deposits, is necessary to justify a payment by the bank out of his funds of a draft which the depositor has accepted made payable at such bank.[4] A bank may apply all the funds of a

[1] Home National Bank *v.* Newton, (1881) 8 Bradw. (Ill.) 563; citing Morse on Banks & Banking (2d ed.), 42; Commercial Bank of Albany *v.* Hughes, 17 Wend. 94.

[2] Home National Bank *v.* Newton, (1881) 8 Bradw. (Ill.) 563; citing Morse on Banks & Banking, 37. The Illinois Appellate Court in Home National Bank *v.* Newton, *supra*, further said: "The neglect of the bank to make such appropriation would discharge the indorsers and sureties. McDowell *v.* Bank of Wilmington, 1 Harrington (Del.), 369; Dawson *v.* Real Estate Bank, 5 Pike (Ark.), 283. The act of thus making his paper payable at a bank is considered as much his order to pay as would be his check, and, if the bank pay without express orders to the contrary, it is a defense to a suit by the depositor for the money so paid. Mandeville *v.* Union Bank of Georgetown, 9 Cranch, 9. And the rule seems to be settled that if a bank advances the money to pay a note or bill of its customer made payable at the bank, it may recover from the depositor as for money loaned, the paper so made payable being deemed equivalent to a request to pay. He makes the bank his agent with implied authority to protect his credit by appropriating his deposits to the payment of his maturing obligations made payable at the bank. Forster *v.* Clements, 2 Camp. 17; Mandeville *v.* Union Bank of Georgetown, 9 Cranch, 9. These general principles are sufficient to show the relation which exists between a bank and its depositors in respect to the paper of the latter made payable by its terms at the bank, and they make the bank the agent, not of the payee of such paper, but of the maker."

[3] Ridgely National Bank *v.* Patton, 109 Ill. 479.

[4] Haines *v.* McFerren, 19 Bradw. (Ill.) 172. As to the lack of power of

depositor which it has to his credit to an indebtedness created by the payment upon a discount by the bank upon him until it is fully discharged.[1] The full balance due a general depositor may be tendered to him at any time by the bank holding it, but he cannot be compelled by the bank to receive less.[2] A bank cannot set off an individual deposit against a partnership debt to the bank.[3] Where money is deposited in a bank in the name of a firm, and the bank pay a check out of the same drawn by one of the firm in his own name only, to justify such payment the bank would be required to show that the money thus drawn on the firm account was applied to the use of the firm.[4] It would be no excuse for a bank, in paying out funds deposited in the name of a firm upon the individual check of a member of that firm, that the partner drawing the check told the officer of the bank that it was drawn on the joint account and in his individual name by mistake, and directed him to pay it and any other of the like kind which he might draw out of the firm's funds.[5] In an Indiana case money in the form of a draft was sent by A. to a bank, with directions to place it to his credit and await his further orders. The banking firm gave a receipt for it. Afterward A. agreed with B. that the draft should be transferred to B.'s credit, but the banking firm was not privy to the agreement, nor did A. notify them of it. B., without authority from A., wrote to the firm, ordering them to place the draft to his credit, and they replied that they had done so. In the suit brought by A. against the bankers after payment of the same was refused by them upon his demand, the Supreme Court held that the bankers were liable to A. for the amount of the draft.[6] A bank is under no obligation to pay checks of its depositors in excess of their deposits, unless there be a special arrangement to that effect.[7] A bank

a bank to transfer money deposited with it to the payment of notes executed by the depositor, payable at the bank, unless depositor consent, see Scott *v.* Shirk, (1877) 60 Ind. 160. As to its not being bound to pay such money on a note held by a third party upon oral request of the depositor when not proposed to surrender the note to the banker or give any other evidence of payment, see McEwen *v.* Davis, (1872) 39 Ind. 109.

[1] Union Bank of Quincy *v.* Tutt, (1878) 5 Mo. App. 342.

[2] Coots *v.* McConnell, 39 Mich. 742.

[3] International Bank *v.* Jones, 119 Ill. 407.

[4] Coote & Jones *v.* Bank of U. S., 3 Cranch Cir. Ct. 50.

[5] Ibid.

[6] Coffin *v.* Henshaw, (1858) 10 Ind. 277.

[7] Decatur National Bank *v.* Murphy, (1881) 9 Bradw. (Ill.) 112.

may maintain an action against the drawer for payment made by its cashier on checks overdrawn.[1] Should a depositor fraudulently overdraw his account, and the identical money is placed by him to his credit in another bank, the bank from which it was drawn may reclaim it from the one in which he has placed it.[2] After receiving from a depositor a genuine check drawn upon it by another depositor, and crediting the amount to the one depositing it, even on the deposit ticket alone, through its receiving teller, a bank cannot return it to the depositor as not good, although the drawer's account may have been overdrawn at the time the check was deposited.[3] A bank receiving a deposit under an agreement to apply it to the payment of a debt due some designated person, cannot divert it from the purposes of the trust by paying it to a different person.[4] Should one to whom a bank has by mistake paid the money of one of its depositors, make any payment to the depositor on that account, the bank would be entitled to a credit for the amount paid on its account with the depositor.[5] Where the bank book of a depositor is written up and balanced, his checks returned and his indebtedness canceled, this constitutes a full settlement of the depositor's account, and, if acquiesced in, it cannot be questioned.[6] The effect of a delay in questioning the accuracy of the balance credited to a depositor on his pass book after it has been written up and returned to him, without objection, if the bank has not suffered by his silence, is to charge him with the burden of establishing fraud, error or mistake in his account. When he does this he is entitled to have it corrected.[7] Where one indebted to a bank has a less sum standing to his credit on deposit on the bank's books, the bank has a right to retain the sum on deposit in part payment of its claim.[8] Where the maker of a note indorsed by the payee to a bank discounting it becomes insolvent before the maturity of the note, having a deposit at the bank, the bank may set off the deposit against the note, and prove the balance, if any, against the maker

[1] Franklin Bank *v.* Byram, 39 Me. 489.

[2] Tradesman's Bank *v.* Merritt, (1829) 1 Paige Ch. 302.

[3] Oddie *v.* National City Bank, (1871) 45 N. Y. 735.

[4] Judy *v.* Farmers & Traders' Bank, (1884) 81 Mo. 404.

[5] Ilgenfritz *v.* Pettis County Bank, (1886) 21 Mo. App. 558.

[6] Peddicord *v.* Connard, 85 Ill. 102.

[7] Frank *v.* Chemical National Bank of New York, (1874) 37 N. Y. Super. Ct. 26.

[8] Union Bank *v.* Cochran, 7 G. & J. (Md.) 138.

in insolvency.[1] A bank holding overdue paper of one of its depositors, would not be bound, though it might have the right, to apply his deposits to the payment of the paper.[2] A bank holding and owning a depositor's past-due note, the amount of which may exceed the amount of his deposit, may, however, hold the deposit account against the note, and refuse to pay checks drawn against the deposit.[3] Where a note was discounted at a bank, for the benefit of the first indorser, and the money was passed to his credit as a deposit, and a portion of it remained in the bank until the note became payable, the Maine Supreme Court of Judicature held that it was optional with the bank to retain this money, in part payment of the note or not; that the omission to retain it did not destroy the bank's right to recover the full amount from another indorser.[4] A bank may secure and discharge any obligation it may assume for a depositor, or which may be imposed upon it by operation of law, as in garnishment proceedings, by retention of a sufficient sum from the deposits in its possession made by the depositor.[5] A bank is not bound to apply subsequent deposits to the payment of a note for the protection of a guarantor.[6] A bank may apply to the discharge of the indebtedness of a depositor on a note which the bank may have discounted, which has not been paid at maturity, all funds of his held at the date of the maturity of the note, or afterwards acquired in the course of business with him, whether a general deposit or commercial paper placed by him in bank for collection.[7] But a bank has no lien upon the deposit of a customer for the purpose of indemnifying itself against a possible loss upon unmatured commercial paper of the customer discounted by the bank.[1] And a bank holding the note of a depositor for a certain sum can, on the morning of the last day of grace upon such note, apply to its payment any money of the depositor then remaining on deposit in the bank.[2] There is no such lien on the funds deposited with a bank in its favor as will allow it to apply the funds of a depositor upon an indebtedness or liability of his not yet due.[3] Neither can a bank retain the money of a depositor to meet a note, the payment of which the

[1] Demmon *v.* Boylston Bank, (1849) 5 Cush. (Mass.) 194. As to the application of a deposit to a note of the depositor falling due in a bank, see Mahaiwe Bank *v.* Peck, (1879) 127 Mass. 298. In Ætna National Bank *v.* Fourth National Bank, (1871) 46 N. Y. 82, it appeared that certain depositors remitted to a bank a check for deposit, with a letter saying, "Please credit to our account and charge us our note of five thousand dollars due 4th inst." The bank received the check and credited it to the depositors on the third, and on that day applied it to the payment of a past-due note of $5,000 made by the depositors and payable at the bank. It was held that the letter accompanying the check was not an assignment of the fund to the holder of the note due the fourth, and that he could not maintain an action against the bank.

[2] Citizens' Bank of Steubenville *v.* Carson, (1862) 32 Mo. 191.

[3] Ehlermann *v.* St. Louis National Bank, (1883) 14 Mo. App. 591.

[4] Ticonic Bank *v.* Johnson, 21 Me. 426.

[5] McEwen *v.* Davis, (1872) 39 Ind. 109.

[6] Bank *v.* Shreiner, 110 Pa. St. 188.

[7] Muench *v.* Valley National Bank, (1881) 11 Mo. App. 144.

[1] State Savings Association *v.* Boatmen's Savings Bank, (1881) 11 Mo. App. 292.

[2] Home National Bank *v.* Newton, (1881) 8 Bradw. (Ill.) 563. This was an action brought by the payee of a check drawn by one Newell upon the bank, which the bank declined to pay for want of funds of the drawer, it having applied his balance to a note of his falling due on the day when this check was presented, the application of the balance being made before the presentation of the check with others for payment. *Arguendo*, the appellate court referred to the following cases, first as to when an action can be brought on paper due with days of grace: Walter *v.* Kirk, 14 Ill. 55; Reese *v.* Mitchell, 41 Ill. 365; Osborn *v.* Moncure, 3 Wend. 170; Smith *v.* Aylesworth, 40 Barb. 104; Wilcombe *v.* Dodge, 3 Cal. 260; Staples *v.* Franklin Bank, 1 Met. (Mass.) 43; Greeley *v.* Thurston, 4 Greenl. (Me.) 479; Dennie *v.* Walker, 7 N. H. 201; Farmers' Bank *v.* Duvall, 7 G. & J. (Md.) 89; Wilson *v.* Williman, 1 Nott & McC. (S. C.) 440; Coleman *v.* Ewing, 4 Humph. 241; Flint *v.* Rogers, 3 Shepley, 67; Leftley *v.* Mills, 4 Term R. 170. They then referred to cases as to the presentment of such notes: Griffin *v.* Goff, 12 Johns. 423; Jackson *v.* Newton, 8 Watts, 401; Farmers' Bank *v.* Duvall, 7 G. & J. (Md.) 78; Mechanics' Bank *v.* Merchants' Bank, 6 Met. (Mass.) 13. They then said: "As a bill or note is payable on the last day of grace, or, when there is no grace, on the day of its maturity, the maker or acceptor has the right to pay it on that day, though he cannot pay it on the day before without the consent of the holder. By making his note payable at the Home National Bank, Newell authorized the bank to pay it at maturity. He constituted the bank his agent, and directed it to pay the note on the day it fell due. The act of making the note payable there, was, as we have already seen, a direction to the bank to appropriate any moneys he might have on deposit to the payment of his note, so far as might be required for that purpose, on the day of its maturity. The law knows no parts of a day in respect to the maturity of commercial paper; Newell's note was equally due at ten o'clock in the morning as at three in the afternoon, and it is no answer to say that an action for its non-payment could not be brought against him for its non-payment until the following day. He authorized his agent to pay it on the day of its maturity, and this must be construed to mean at any hour of the day."

[3] Merchants' National Bank *v.* Ritzinger, 20 Bradw. (Ill.) 27; Jordan *v.* National Shoe & Leather Bank, 74 N. Y. 467; s. c., 30 Am. Rep. 319; Bank *v.* Jones, 2 Pennypacker (Pa.), 377.

depositor may have guaranteed, the note not being due at the time.[1] Where the maker of a note held by a bank has funds in the bank on general deposit when the note falls due, the bank is bound to apply the funds to his credit in payment of the note; if it fails to do so, the indorser upon the note will be thereby discharged from liability.[2] A bank holding a depositor's note must charge it against his account at maturity, or else the indorser will be discharged.[3] A bank will be bound to pay a note payable at its counter, of which it is the owner, with any general deposit of the maker in its hands. Should it let the note go to protest, the indorsers would be discharged.[4] A bank may refuse to apply a deposit of the maker of a note after maturity, so as to relieve the indorser.[5] In the absence of express directions, or an agreement to that effect, it is optional with a bank whether it will apply a general deposit made by the maker of a note held by it which is past due, on the note or not. It is under no obligation to do so, even as to an indorser. The general deposit does not of itself operate as a payment of such a note.[6] A debt due by a depositor to a bank will be extinguished by a check drawn in payment of it, the check operating as an appropriation of the fund from the time of its presentment.[7] The Supreme Court of Missouri have affirmed a holding of a lower court that, where a bank had received from a non-resident money which it had agreed to invest for him in real estate security, and having passed the same to his credit, led him to believe that the investment had been made, and subsequently assigned its assets for the benefit of its creditors, the relation of trustee and *cestui que trust* existed and not that of depositor and depositary between them, and that the bank was liable for wrongfully mixing the money with its own.[8] In a case where a draft was deposited in a bank, drawn against by a check, and the check certified to the bank in which it was to be deposited, and before the check arrived the bank certify-

[1] Commercial National Bank *v.* Proctor, (1881) 98 Ill. 558.

[2] McDowell *v.* Bank of Wilmington & B., 1 Harr. (Del.) 369.

[3] Bank *v.* Foreman, 27 W. N. C. (Pa.) 154.

[4] Bank *v.* Henninger, 105 Pa. St. 496. As to the duty of a bank to sureties on promissory notes as to deposits in its hands, see Bank *v.* LeGrand, 13 W. N. C. (Pa.) 317.

[5] Huckstein *v.* Herman, 1 Walk. (Pa.) 92.

[6] National Bank of Newburgh *v.* Smith, (1876) 66 N. Y. 271; s. c., 23 Am. Rep. 48.

[7] Laubach *v.* Leibert, 87 Pa. St. 55.

[8] Harrison *v.* Smith, (1884) 83 Mo. 210.

ing it had made an assignment, it was held that the fund remained in the first bank impressed with the trust, and that the relation of general creditors was not created between the depositors and the bank.[1] A court in Illinois having by order made a bank a depository of court funds and of funds of its officers, a clerk of the court made a deposit of funds belonging to the court in the bank, just as other depositors did, the money being commingled with that of the bank, and there being no agreement to keep the funds separate. The bank became insolvent and was placed in the hands of a receiver. The Illinois Supreme Court held that the deposit being a general one, and not a mere naked bailment, and there being no means of identifying the money deposited, even if the assets of the bank were in the hands of the receiver, it was error to require the receiver to pay the deposit in full; that the clerk was only entitled to share *pro rata* with other depositors and creditors of the bank.[2] Where the circumstances under which a lost check came into plaintiff's possession were so suspicious that a person of ordinary prudence ought to have hesitated and examined further before buying, the Supreme Court of Louisiana held that no recovery could be had on it.[3] Where a bank check was received in payment, during banking hours, the day it was drawn, in the usual course of business, under circumstances not suspicious, and no negligence was shown from which bad faith could be inferred, the same court held that the holder might recover from the drawer, though the check had been lost or stolen.[4] A bank having, without instruction, paid a forged

[1] Stoller *v.* Coates, (1885) 88 Mo. 514, holding the bank chargeable with the amount of the converted fund as a preferred demand. In State ex rel. Girardey *v.* Southern Bank, 33 La. Ann. 957, it appeared that the Bank of Commerce sent to the Southern Bank for collection three checks on other banks in New Orleans. The checks were collected and the proceeds passed to the credit of the Bank of Commerce in its general account, as it had given no instructions for any special disposition of the money, but, on the contrary, drew against the proceeds of these checks as an ordinary depositor. On the same day that the checks were collected the assets of the Southern Bank were seized by the sheriff, and receivers were appointed. The Bank of Commerce claimed in this case the *restitutio ad integrum* of the proceeds of the three checks. The Supreme Court held that the Bank of Commerce was an ordinary depositor of the Southern Bank; that the proceeds of the checks were mixed with its general funds, and the Bank of Commerce was no more than an ordinary creditor.

[2] Otis *v.* Gross, (1880) 96 Ill. 612.

[3] Vairin *v.* Hobson, 8 La. 55.

[4] Marsh *v.* Small, 3 La. Ann. 402.

acceptance, and sent the same by mail to the firm whose names were forged as acceptors, the Kansas Supreme Court held, were not thereby entitled to a credit for the amount of the payment against the firm. The firm, as the court viewed it, were under no legal obligation to immediately examine the acceptance upon its being received by them, to ascertain whether it was genuine or not, and were not chargeable with negligence for not discovering the forgery immediately. In such a case it was sufficient to give notice when the forgery was discovered.[1] One having inclosed a note in a letter to a bank and asked the bank to discount it and place the proceeds to the writer's credit, and in that event to charge a certain overdraft of a corporation against the credit, and the bank having declined to discount the note, the United States Supreme Court held that the bank had no right to hold the note as collateral for the overdraft.[2]

§ 324. **Checks, generally.**— Checks, like bills, are generally negotiable instruments payable to bearer, sometimes to order, requiring as essentials a drawer, drawee and payee.[3] That it shall be instantly payable on demand is an essential characteristic of a check upon a bank.[4] The payment of a check, before made, can be countermanded by the drawer.[5] Although not identical with a bill, a check on a bank is, in many respects, governed by the same rules; and when payable to order is negotiable by indorsement.[6] The effect of drawing a check by a depositor upon his banker is to transfer the sum named to the payee, provided the depositor has that sum to his credit on the books of the banker, and an assignment of the check carries the title to the

[1] First National Bank *v.* Tappan, (1870) 6 Kans. 456.

[2] Bank of Montreal *v.* White, (1880) 14 Sup. Ct. Rep. 1191.

[3] Hewitt *v.* Goodrich, 10 La. Ann. 340. In Ridgley National Bank *v.* Patton 109 Ill. 479, an instrument drawn by a depositor in this form, after giving the date and the name of the bank: "Pay to A. and B. for account of C. & Co., ten hundred and eighteen 23-100 dollars." and signed by the depositor, was held to be a valid check, and that it operated to transfer that sum out of the funds of the drawer in bank to the drawee for the purposes named in the check. For an illustration of what would be a banker's check and not an ordinary bill of exchange, see Harrison *v.* Wright, (1884) 100 Ind. 515.

[4] Merchants' National Bank *v.* Ritzinger, 118 Ill. 484.

[5] Albers *v.* Commercial Bank, (1884) 85 Mo. 173; Bank *v.* Bank, 118 Pa. St. 294.

[6] Barbour *v.* Bayon, 5 La. Ann. 304.

fund to each successive holder.[1] But a banker is not bound to pay the check of a depositor in anything but money. So, where a depositor drew a check upon his banker for Chicago exchange, which he was to send to his creditors at their request, the Appellate Court of Illinois held that these creditors could not, upon failure of the depositor to send the Chicago draft, maintain an action against the banker upon the original check drawn upon him.[2] A bank check payable in "current funds" is payable in whatever is current by law as money.[3] When a check is drawn upon a bank payable to the drawer's order and assigned by him, and he has not sufficient money to his credit to pay the check in full, the bank will be under no obligation to pay, and an assignee can have no recovery upon such a check in an action against the bank.[4] A draft given on a bank in the ordinary course of business does not constitute an equitable assignment of the fund.[5] And, in this case, it was held that it was not sufficient to constitute such an assignment that the draft was drawn by a bank against its reserve fund in another city, and was given in exchange for clearing-house certificates upon the representation of its president that it owed a heavy debt at the clearing house which it was unable to meet, and his further statement showing the amount of the reserve fund against which the draft was drawn.[6] A bank by retaining, on the settlement of a depositor's account, the exact

[1] Merchants' National Bank *v.* Ritzinger, 20 Bradw. (Ill.) 27; Bank of America *v.* Indiana Banking Co., 114 Ill. 483. As to the drawing of a check by a depositor upon the bank holding the deposits operating to transfer the title to the sum named in the check, see Foster *v.* Paulk, 41 Me. 425; Hogue *v.* Edwards, (1881) 9 Bradw. (Ill.) 148; Union National Bank *v.* Oceana County Bank, 80 Ill. 212. And that the payee may sue the bank therefor, see Brown *v.* Pierce, 80 Ill. 214; C. M. & F. Ins. Co. *v.* Stanford, 28 Ill. 168; Bickford *v.* First National Bank, 42 Ill. 239; Brown *v.* Leckie, 43 Ill. 497; Seventh National Bank *v.* Cook, 73 Pa. St. 485.

[2] Hogue *v.* Edwards, (1881) 9 Bradw. (Ill.) 148. A rehearing of this case was denied in Hogue *v.* Edwards, (1881) 9 Bradw. (Ill.) 263.

[3] Bull *v.* Bank of Kasson, 123 U. S. 105.

[4] Coates *v.* Preston, 105 Ill. 470. In Pack *v.* Thomas, 13 Smedes & Marsh. (Miss.) 11, it was held that it was not competent to prove by parol that a check payable in "dollars" simply, was intended by the parties to be paid in depreciated bank notes, as that would be to vary a written contract by parol.

[5] Bank *v.* Millard, 10 Wall. 152; Bank *v.* Schuler, 120 U. S. 511; s. c., 7 Sup. Ct. Rep. 644.

[6] Fourth Street National Bank *v.* Yardley, (1893) 55 Fed. Rep. 850 (a bill against the receiver of the bank to charge him as trustee of a fund).

amount of an outstanding check, impliedly accepts the check, and subjects itself to an action by the holder upon the check.[1] An unaccepted and uncertified check not being an equitable assignment to the credit of the holder, is but an order which may be countermanded.[2] Should the paying teller of a bank after a notice to the bank by the drawer of a check not to pay it, and his promise that he would not do so, afterwards pay it to the holder, the drawer may recover from the bank the amount of the check so paid.[3] A check upon a bank is payable in the kind of funds deposited prior to its date, and a subsequent agreement between the depositor and the bank that other funds would be received is not binding upon the payee of the check.[4] It appeared in an Illinois case that at a time when the banks in that state were receiving and paying out the paper of Illinois banks which were of doubtful solvency, and their paper at a discount, two bankers, in the usual course of their business, had mutual accounts growing out of remittances and collections, and the relations existing between them were such that the depositor could withdraw his funds at pleasure, and the receiver of the deposits could in like manner return them. The Supreme Court of that state held that, in the absence of any agreement between them on the subject, the holder of the deposits would be compelled to pay, or return in current funds or funds at par. But the banker who owned the deposit, with a considerable balance to his credit with his correspondent, having notified the latter by letter that he should require that any remittances he might desire should be made in the paper of certain banks, which were specified in his letter, it was held that this direction left the holder of the deposits at liberty to make the remittances in bills of any of the banks so designated, which the owner of the deposits would be compelled to receive at their nominal value. Further, that after the receipt of such letter, the holder of the deposits was authorized to remit to the owner the entire balance standing to his credit, without further order, in the class of paper designated in the letter, at its nominal value, or in the paper of any one of the banks designated. Further, this right of the holder of the deposits would not be affected by the fact that subsequent to the notice given him, and before he had received any further notice on the subject, the paper of such banks had continued to depreciate in value. It appeared also in this case that the holder of the deposits had transmitted to the owner the entire balance due him in a package of these bills; the latter retained it a week without opening it to learn the character of its contents, knowing it was a remittance from his correspondent, and the amount of it, and did not notify the correspondent that he would not receive it. The court held that by such delay he waived even any right he may have had to refuse to receive, at its nominal value, any of the paper of banks contained in the package.[1] An individual depositor may draw a check in favor of a *bona fide* creditor and appropriate his funds in a bank to such creditor, vesting him with full power to sue the bank and recover upon the check, notwithstanding an indebtedness to the bank of a partnership of which the depositor is a member.[2] A check duly notified to the bank upon which it is drawn constitutes an equitable assignment of the fund on which it is drawn.[3] A check upon a bank certified by its teller is equivalent to a bill of exchange accepted by the bank, and the bank is liable on the certified check to a *bona fide* holder whether it had funds of the drawer or not.[4] A check drawn by one *in extremis*, with directions to the payee to defray the funeral expenses of the drawer from the amount, and to pay the balance to his heirs, not accepted by the bank at the death of the drawer, has been held not to have operated as an assignment of the fund so as to make the bank liable to the payee.[5] The Indiana Supreme Court has held that a banker's check drawn upon the drawer's banker without words of transfer, and drawn upon no

[1] Saylor *v.* Bushong, 100 Pa. St. 27. As to the drawer of a bank check being relieved of liability by a delay of nine days' presentment of a check, see Kinyon *v.* Stanton, 44 Wis. 479; Cork *v.* Bacon, 45 Wis. 192.

[2] Florence M. Co. *v.* Brown, 124 U. S. 385.

[3] Schneider *v.* Irving Bank, (1865) 1 Daly, 500; s. c., 30 How. Pr. 190. As to the duty of a bank in the payment of checks drawn upon it by a depositor, see Dodge *v.* National Exchange Bank, (1870) 20 Ohio St. 234.

[4] Marine Bank of Chicago *v.* Ogden, (1862) 29 Ill. 248.

[1] Cushman *v.* Carver, (1869) 51 Ill. 509. See, also, Marine Bank of Chicago *v.* Rushmore, 28 Ill. 463; Marine Bank of Chicago *v.* Chandler, 27 Ill. 525.

[2] International Bank *v.* Jones, 119 Ill. 407.

[3] Gordon & Gomila *v.* Muchler, 34 La. Ann. 604.

[4] Meads *v.* Merchants' Bank of Albany, (1862) 25 N. Y. 143.

[5] Second National Bank *v.* Williams, 13 Mich. 282. That a check is an appropriation of so much money in the bank to the payee and holder, see Chouteau *v.* Rowse, (1874) 56 Mo. 65; Lewis *v.* International Bank, (1883) 13 Mo. App. 202.

particular designated fund, did not of itself, either as between the drawer and drawee, or drawer and payee or holder of the check, act as an appropriation or equitable assignment of a fund in the hands of the drawee; nor did it operate as an assignment of a part of the drawer's chose in action against the drawee; and, hence, the holder of the check was not entitled to a preference as against the depositors and the general creditors of an insolvent drawer.[1] If bank bills are deposited as depreciated paper, the depositor has no right to draw for funds at par or expect payment on a check thus drawn.[2] A right of action is given to the drawer of a check in case he has funds in bank to meet it by the refusal of the bank to pay it, if the refusal to pay is without his authority.[3] The presenting of a check to a bank on which it is drawn for payment, and the bank's stamping it paid and canceled, although not in fact paid, but subsequently returned to the collecting bank presenting it, would not be such a payment as would discharge the drawer.[4] A bank paying a check drawn to order, without the indorsement of the payee, before it can refuse to pay upon demand by the payee having possession of the paper, is bound to prove that the payee has parted with his title.[5] To a national bank's action to recover an overdraft which amounts to a simple loan, the omission of an officer of the bank to exact security for the money loaned cannot be made a ground of defense.[6] A banker cannot set off a demand he holds against the person presenting a check for payment.[7] A check drawn upon a bank for more than the amount of the drawer's funds on deposit creates no

[1] Harrison *v.* Wright, (1884) 100 Ind. 515.

[2] Willetts *v.* Paine, (1867) 43 Ill. 432. See Lawrence *v.* Schmidt, 35 Ill. 440; Galena Ins. Co. *v.* Kupfer, 28 Ill. 332.

[3] Citizens' National Bank of Davenport *v.* Importers', etc., National Bank of New York, (1887) 44 Hun, 386.

[4] McIntosh *v.* Tyler, (1888) 47 Hun, 99; citing Turner *v.* Bank of Fox Lake, 4 Abb. Ct. of App. Dec. 434; s. c., 3 Keyes, 425; Burkhalter *v.* Second National Bank, 42 N. Y. 538; Kelty *v.* Second National Bank, 52 Barb. 328.

[5] Citizens' National Bank of Davenport *v.* Importers', etc., National Bank of New York, (1887) 44 Hun, 386.

[6] Union Gold Mining Co. *v.* Rocky Mountain National Bank, (1873) 2 Colo. 248.

[7] Brown *v.* Leckie, (1867) 43 Ill. 497. The court said: "In the case of Cromwell *v.* Lovett, 1 Hall, (N. Y.) 56, it was held that a check on a banker given in the ordinary course of business, is not presumed to be received as an absolute payment, even if the drawer have funds in the bank, but as the means to procure the money. The holder, in such a case, becomes the agent of the drawer to collect the money, and if guilty of no negligence whereby an actual injury is sustained by the owner, he will not be answerable, if,

lien upon, and will give the payee no right to the actual balance, until the bank has agreed to pay it *pro tanto*.[1] The Illinois Supreme Court has held that the holder of a bank check, who has paid value for it, is entitled to as much of the funds of the drawer on deposit as the check calls for, and, when presented for payment, the bank on which it is drawn will become the holder of the drawer's money to the use of the holder of the check, and will be bound to account to him for the amount unless other equities have intervened.[2] The rights of the holder of the check and the bank are fixed from the time the check is presented for payment, and the bank will have no right, subsequently, to pay other checks or other demands either to itself or to others which may afterwards be presented, or which may afterwards accrue.[3] A bank receiving an indorsed check for a special purpose, not in the regular course of banking business, has been held to be responsible for an erroneous appropriation of the proceeds.[4] The payee of a check has been held not responsible to a bank for amount

from any peculiar circumstances attending the bank, the check is not paid. And in a suit against the drawer for the consideration of such a check, the holder may treat it as a nullity, and resort to the original cause of action."

[1] Dana *v.* Boston Third National Bank, (1866) 13 Allen, (Mass.) 445.

[2] Fourth National Bank of Chicago *v.* City National Bank of Grand Rapids, 1873) 68 Ill. 398.

[3] Ibid. Mr. Justice BREESE said: "The universal custom informs us what the contract of all the parties to such transaction is. It informs us that the banker, when he receives the deposit, agrees with the depositor to pay it out on the presentation of his checks, in such sums as those checks may specify, and to the person presenting them, and with the whole world the banker agrees that whoever shall become the owner of such check shall, upon presentation thereof, become thereby the owner, and entitled to receive the amount specified in the check, provided the drawer shall at that time have that amount on deposit. It was further said in Munn *v.* Burch, 25 Ill. 35, to deny to the holder of a bank check both a legal and equitable right, after presentation of the check, to the money of the drawer in the hands of a banker, would destroy the most valuable feature of bank deposits and checks. In the very nature of such transactions a banker's lien cannot extend to the money left on deposit with him, according to the customs and usages of banks. It has never been so extended, but is confined to securities and valuables which may be in the banker's custody as collaterals. The credit must be given on the credit of the securities or valuables, either in possession or expectancy. Russell *v.* Hadduck, 3 Gilm. 233. This is the extent of a banker's lien." See, also, Johnson *v.* Ward, 2 Bradw. (Ill.) 261; Brahm *v.* Adkins, 77 Ill. 263. When the holder of a check is not subject to equities existing between the original parties. Rochester Bank *v.* Harris, (1871) 108 Mass. 514; Ames *v.* Meriam, (1867) 98 Mass. 294.

[4] Parker *v.* Hartley, 91 Pa. St. 465.

paid to him, without fraud on his part, although paid by mistake.[1] The mere presentment of a check does not fix upon a bank the liability to pay it.[2] Should a bank, without funds, pay a check long overdue, it would take it subject to all the equities of the drawer.[3] A bank, though it may have by mistake paid a check and placed it upon the canceling knife, would not be thereby prevented from recovering upon it against the drawer.[4] One receiving a counterfeit bill from a bank in payment of a check may return it in a reasonable time after discovering that it is not genuine.[5] The drawer of a check and his sureties will be discharged by the acceptance of the drawee, with the consent of the payee of a check conditionally fixing some other time or mode of payment than is implied in the language and terms of the check.[6] No law requires the drawee of a check to delay payment until advice that it has been drawn.[7] A check to bearer, taken, though from one who obtained it unfairly, yet immediately after its issue, and without notice, entitles the holder to recover the sum it calls for.[8] Where a check is drawn on a bank in which the drawer has no funds it need not be presented at all, in order that an action may be maintained upon it.[9] Should a bank pay a post-dated check before the day on which it is dated, it will be a payment to its own wrong, and no defense to an action for the amount of the fund by one to whom it may have been assigned in good faith.[10] A bank on which a check is drawn is not constituted an agent for the owner of the check to receive the proceeds by his sending the check to it through the mail.[11]

[1] Hull *v.* Bank, Dud. (S. C.) 259.

[2] Albers *v.* Commercial Bank, (1884) 85 Mo. 173.

[3] Lancaster Bank *v.* Woodward, 18 Pa. St. 357.

[4] State Savings Association *v.* Boatmen's Savings Bank, (1881) 11 Mo. App. 292.

[5] Boyd *v.* Mexico Southern Bank, (1878) 67 Mo. 537. In Murray *v.* Bull's Head Bank, (1871) 3 Daly, 364, a bank which had through its teller cashed a check drawn on another bank, and part payment was made in a counterfeit bank bill, was held liable for the amount of the counterfeit bill to the owner of the check.

[6] Warrensburg Co-operative Building Assn. *v.* Zoll, (1884) 83 Mo. 94.

[7] Merchants' Bank *v.* Exchange Bank, 16 La. 457.

[8] Clark *v.* Stackhouse, 2 Mart. (La.) 326.

[9] Foster *v.* Paulk, 41 Me. 425.

[10] Godin *v.* Bank of Commonwealth, (1856) 6 Duer, 76.

[11] People *v.* Merchants & Mechanics' Bank of Troy, (1879) 78 N. Y. 269; s. c., 34 Am. Rep. 532.

§ 325. Certification of checks.— A bank may render itself liable to the holder and payee of a check by a formal acceptance written upon the check, in which case it stands to the holder in the position of a drawer and acceptor of a bill of exchange.[1] The same result may be accomplished by the bank's writing upon the check the word "good" or any similar words which indicate a statement by it that the drawer has funds in the bank applicable to the payment of the check, and that it will so apply them.[2] Such a certificate discharges the drawer of the check, and, as to him, amounts to a payment.[3] The certifying of a check as "good" is not a mere declaration of an existing fact, but creates a new and binding obligation on the part of the bank. Its meaning is not merely that the check was "good" when certified, but that it shall be "good" when presented for payment. A certified check, therefore, is as truly an absolute, unconditional promise to pay upon demand the sum it specifies, as an ordinary bank note; and *laches* in making the demand is no more imputable in the one case than in the other.[4] The fact that a check may have been properly drawn on a national bank (a public depository) by an officer of the government in favor of a public creditor does not alter the rule that the holder of a bank check cannot sue the bank for refusing payment in the absence of proof that it was accepted by the bank or charged against the drawer.[5] Payment to a stranger upon an unauthorized indorsement of a check will not operate as an acceptance of the check so as to authorize an action by the real owner to recover the amount of the check as upon an accepted check.[6] Although certified checks pass from hand to hand as cash, they are not cash, or currency, in the legal sense of the terms, and they do not lose, on that account, any of the char-

[1] Merchants' Bank *v.* State Bank, 10 Wall. 604; Espy *v.* Bank of Cincinnati, 18 Wall. 604.

[2] Cook *v.* State Bank of Boston, 52 N. Y. 96.

[3] Bank *v.* Leach, 52 N. Y. 350; Meads *v.* Merchants' Bank, 25 N. Y. 143; Mussey *v.* Prest., Directors, etc., Eagle Bank, 9 Met. (Mass.) 311; Willets *v.* Phœnix Bank, 2 Duer, 121.

[4] Willets *v.* Phœnix Bank, (1853) 2 Duer (N. Y.), 121. Holding upon the doctrine of the text that the plaintiffs, holders for value, were entitled to recover the sum advanced by them upon four checks certified by the bank, although payment was not demanded until two months after the checks were certified, and in the interval the drawer had withdrawn, upon other checks, all his funds from the bank.

[5] Bank of the Republic *v.* Millard, 10 Wall. 152.

[6] First National Bank of Washington *v.* Whitman, (1876) 94 U. S. 343.

acteristics of bills of exchange, and, therefore, when dishonored, the holder has a right to look to the drawer for payment.[1] The only effect of certifying a check "good" is to give it additional currency by carrying with it the evidence that it was drawn in good faith on funds to meet its payment, and lending to it the credit of the drawee in addition to the credit of the drawer. Beyond this it does not differ from an uncertified check.[2] The indorsement, by the proper officer of a bank, upon a check drawn upon it payable to bearer, that it is "good," would be *prima facie* an admission on the part of the bank that the money drawn for is in bank, subject to the order of the drawer. This presumption, however, may be repelled by proof, as that the admission was made by mistake.[3] Certifying a check is only an agreement that the signature of the drawer is genuine, and that he has funds to meet it.[4] A bank will not be relieved from its responsibility to the innocent holder of a check certified by its officer authorized to do so, by the fact that he may have transgressed his authority and certified checks where the drawer had no funds.[5] Where a check had been delivered by the drawer to the payee for accommodation, and the payee had transferred it without indorsement to another, who took it to the bank on which it was drawn for certification, and while it was so in the possession of the bank the drawer notified the bank not to pay it, it was held by the Supreme Court of New York that the payment of the check by the bank was unauthorized, and that the drawer could recover the amount from the bank.[6] A bank will not be bound, by a parol representation that a check is good, to pay it whenever presented until barred by limitation, such a representation not being equivalent to a certification; neither would the holder of the check be relieved from the duty of proper diligence in presenting it for payment.[7] The deposit of the drawer of a check upon which it is drawn, is paid as the effect of the holder of the check procuring it to be

[1] Bickford *v.* First National Bank, 42 Ill. 238.

[2] Brown *v.* Leckie, (1867) 43 Ill. 497; citing Rounds *v.* Smith, (1860) 42 Ill. 245; Bickford *v.* First National Bank, 42 Ill. 238.

[3] Smith *v.* Branch Bank at Mobile, (1845) 7 Ala. 880.

[4] Marine National Bank *v.* National City Bank, (1874) 59 N. Y. 67; s. c., 17 Am. Rep. 305. As to the power of a bank to certify checks, see Merchants' Bank *v.* State Bank, 10 Wall. 604.

[5] Hill *v.* Trust Co., 108 Pa. St. 1.

[6] Freund *v.* Importers & Traders' National Bank, (1875) 3 Hun, 689; s. c., 6 T. & C. 236.

[7] Bank of Springfield *v.* First National Bank of Springfield, (1888) 30 Mo. App. 271.

certified instead of collecting it.[1] The drawer of a check will be discharged by the holder's procuring it to be certified instead of collecting it.[4] In case a certificate of "good" on a check be erroneously made by a bank, and the error be discovered and notice given to the bank presenting the check in time for it to make a re-presentment and charge the indorsers, the certifying bank will be relieved from further liability.[3] A new and binding obligation is created on the part of a bank by its certifying a check as "good" to hold sufficient funds of the drawer to meet the check; and the holder's right is not impaired by a delay on his part in demanding payment.[4] The act of a bank certifying the genuineness of a check and directing its payment by a correspondent bank, operates as a promise to pay the check upon presentation at the correspondent bank, properly indorsed. The obligation of the bank, as shown by such certification, amounts to a representation that the drawer has funds in the bank with which to pay the check, and that it will retain and pay them to the holder through the designated agency, upon presentation there, properly indorsed.[5] A bank certifying a check drawn upon it by one of its depositors is primarily liable upon it.[6] One taking a check which has been certified by a bank in good faith, for value, in the ordinary course of his business, may recover against the bank although the signature to the check may be a forgery. And it

[1] Bills *v.* National Park Bank, 47 N. Y. Super. Ct. 302.

[2] First National Bank of Jersey City *v.* Leach, (1873) 52 N. Y. 350; s. c., 11 Am. Rep. 708.

[3] Irving Bank *v.* Wetherald, (1867) 36 N. Y. 335, affirming 34 Barb. 323.

[4] Farmers & Mechanics' Bank *v.* Butchers & Drovers' Bank, (1855) 4 Duer, 219. In Mills *v.* State Bank, 5 N. J. Law J. 56, it appeared that on a certain date a check was drawn in favor of the plaintiff on the State Bank, and indorsed by the cashier "good at the Mechanics' Bank." The plaintiff retained the check for two months, when the Mechanics' Bank failed. In this action, on proof that at the date of the failure of the Mechanics' Bank the State Bank had sufficient funds in that bank to meet the check, the plaintiff was held not entitled to recover, on account of her negligence in delaying the presentation of the check for payment for so long a time.

[5] Lynch *v.* First National Bank of Jersey City, (1887) 107 N. Y. 179; s. c., 1 Am. St. Rep. 803; citing Ætna National Bank *v.* Fourth National Bank, 46 N. Y. 82; Crawford *v.* West Side Bank, 100 N. Y. 50; Risley *v.* Phenix Bank, 83 N. Y. 318; Oneida Bank *v.* Ontario Bank, 21 N. Y. 490.

[6] Drovers' National Bank *v.* Provision Co., 117 Ill. 100. As to what the liability of a bank upon certified checks results from, see Cooke *v.* State National Bank of Boston, (1873) 52 N. Y. 96; s. c., 11 Am. Rep. 667.

would make no difference that the payee's name was fictitious.[1] The money paid upon a raised check by a bank certifying and paying it may be recovered from the one receiving it, as for money paid under a mistake of fact.[2] The money paid by a bank upon a certified check may be recovered if it prove that the filling in of the check was forged. And the bank will not be estopped from showing the body of the check to be a forgery by the verbal assurance of its teller to the payee that the check was correct in every particular.[3] Payment of a raised check on the faith of a certificate of a bank has been held not to raise an estoppel precluding the bank from recovering back the money paid on it.[4]

§ 326. Acceptance of a check by a bank — illustration.— In a case in the United States Circuit Court for the western district of Missouri it appeared that a cattle company had agreed to sell to one T. a large number of cattle for a fixed sum of money. He offered in payment for the cattle his check on defendant bank. The cattle company refused to accept it unless persons to whom it was indebted would accept it in payment of the debt. The payee of the check telegraphed to the bank asking if it would pay T.'s check for the amount specified, and the bank telegraphed: "T. is good. Send on your paper." The telegram was shown to the creditors of the cattle company, who took the check in payment of their debt. Upon the issues raised by the defendant's answer it was held that the answer by the bank was an acceptance of the check for the sum named in the first telegram, and was sufficient, under Revised Statutes of Missouri (§ 533), providing that an acceptance of a bill of exchange must be in writing, and section 534, providing that an acceptance on a separate paper will bind the acceptor in favor of one to whom it has been drawn, who takes the bill on the faith thereof for a valuable consideration, to render the bank liable to plaintiffs on the check. And in such case, the evident purpose of the inquiry

[1] Hagen *v.* Bowery National Bank, (1872) 6 Lans. 490; s. c., 64 Barb. 197.

[2] St. Nicholas Bank *v.* National Bank of the State of New York, (1876) 3 N. Y. Wkly. Dig. 583; citing Marine Nat. Bank *v.* National City Bank, (1874) 59 N. Y. 67; s. c., 17 Am. Rep. 305.

[3] Security Bank of New York *v.* National Bank of Republic, (1876) 67 N. Y. 458; s. c., 23 Am. Rep. 129.

[4] Marine National Bank *v.* National City Bank, (1874) 59 N. Y. 67; s. c., 17 Am. Rep. 305.

being to obtain assurance of payment before taking the check, the bank was liable under Revised Statutes of Missouri (§ 535), providing that an unconditional written promise to accept a bill before it is drawn shall be deemed an actual acceptance in favor of any person to whom it is shown, and who on the faith thereof receives the bill for a valuable consideration.[1] The same case was before the court again, when there were some further rulings as to the bank's liability on the check by reason of its acceptance by telegram. It was held that the bank which had agreed to accept the check for a certain sum could not refuse payment because the check when presented concluded with the words "with exchange," no place of exchange being mentioned. Still this was mere surplusage, and of no effect.[2] It was also held that a bank check payable to "the order of" the payee was a bill of exchange within the meaning of Revised Statutes of Missouri (§ 553), requiring an acceptance of a "bill of exchange" to be in writing.[3]

§ 327. Presentment of checks for payment.— Upon presentation of a check for payment the payee or legal holder becomes the owner, entitled to the sum called for by the check, if that amount stands to the credit of the drawer on the books of the bank.[4] Bank checks being payable immediately on present-

[1] Garrettson *v.* North Atchison Bank, (1889) 39 Fed. Rep. 163. As to principles applicable to bank checks, see Bank *v.* Bank, 10 Wall, 647; Cooke *v.* Bank, 52 N. Y. 96; Jarvis *v.* Wilson, 46 Conn. 90–92; Freund *v.* Bank, 76 N. Y. 355, 356; Bank *v.* Richards, 109 Mass. 413; Whilden *v.* Bank, 64 Ala. 29, 30. As to how an acceptance of a check may be made, see Bank *v.* Bank, 1 N. Y. Leg. Obs. 26; Espy *v.* Bank, 18 Wall. 604; Whilden *v.* Bank, 64 Ala. 32, 33; Bank *v.* Howard, 40 N. Y. Super. Ct. 20. As to a check passing to another for a valuable consideration, see Railroad Co. *v.* Bank, 102 U. S. 14–22; Pope *v.* Bank, 59 Barb. 226; Freund *v.* Bank, 76 N. Y. 353–358.

[2] Garrettson *v.* North Atchison Bank, (1891) 47 Fed. Rep. 867. C. f., Brinkman *v.* Hunter, 73 Mo. 179; Lindley *v.* Bank, 76 Iowa, 629; s. c., 41 N. W. Rep. 381; Hughitt *v.* Johnson, 28 Fed. Rep. 865; Hill *v.* Todd, 29 Ill. 101–103; Clauser *v.* Stone, 29 Ill. 114. As to a defense that presentation of a check for payment was unreasonably delayed, see Bull *v.* Bank, 123 U. S. 111, 112; s. c., 8 Sup. Ct. Rep. 62.

[3] Garrettson *v.* North Atchison Bank, (1891) 47 Fed. Rep. 867, affirming Garrettson *v.* North Atchison Bank, (1889) 39 Fed. Rep. 163. Garrettson *v.* North Atchison Bank, 39 Fed. Rep. 163, and 47 Fed. Rep. 867, were affirmed by the United States Circuit Court of Appeals in North Atchison Bank *v.* Garrettson, (1892) 51 Fed. Rep. 168.

[4] Shaffner *v.* Edgerton, 13 Bradw. (Ill.) 132; Priest *v.* Way, 87 Mo. 16; Munn *v.* Burch, 25 Ill. 35.

ment are not entitled to days of grace.[1] Whether days of grace are to be allowed on a draft in the form of a check depends upon the question whether the instrument is payable on demand or at a future day.[2] A check drawn on a bank ordering it to pay money to a third party or order on a day subsequent to its date would be entitled to grace.[3] A check drawn by one party upon another payable to a third person, due thirty days after date, has been held in a suit by the drawee against the drawer to be entitled to days of grace.[4] An instrument drawn upon the cashier of a bank, payable sixty days after date, has been held to be a bill of exchange, and entitled to days of grace. It was also held in the same case that it was essential to a check, *eo nomine*, that it should be payable on demand.[5] A draft on a bank for money payable at a day subsequent to its date, has been held to be a bill of exchange, and entitled to days of grace.[6] A bank check payable fifteen days after date has been declared in an Indiana case to be an inland bill of exchange, and to have every feature of such a bill.[7] A demand in business hours on the day succeeding that on which a check is drawn is a sufficient presentment.[8] Presentment of a check is excused by the stoppage of its payment by the drawer.[9] The fact that a check may be drawn by a depositor of funds in a bank in favor of the cashier of the bank just previous to the service upon the bank of process in garnishment, has been held not to be in itself evidence of fraud or want of good faith.[10] A bank which had sent another bank a bad check, supposing and affirming that it came from the bank to which it was returned and been paid money by the latter for the check, relying upon this statement, which was erroneous, has been held liable in an action by the latter for the money, as paid under a mistake of fact, although the error in the statement was not discovered until three days after the payment of the money, when the

[1] Barbour *v.* Bayon, 5 La. Ann. 304.

[2] Morrison *v.* Bailey, (1855) 5 Ohio St. 13. When an instrument drawn on a bank is a check and not a bill of exchange, and not entitled to days of grace, see Andrew *v.* Blachly, (1860) 11 Ohio St. 89.

[3] Ivory *v.* Bank of Missouri, (1865) 36 Mo. 475.

[4] Cutler *v.* Reynolds, (1872) 64 Ill. 321.

[5] Woodruff *v.* Merchants' Bank, 25 Wend. 673.

[6] Bowen *v.* Newell, 8 N. Y. 190.

[7] Glenn *v.* Noble, 1 Blackf. (Ind.) 104.

[8] Ocean Co. *v.* Ophelia, 11 La. Ann. 28.

[9] Woodin *v.* Frazee, (1874) 38 N. Y. Super. Ct. 190.

[10] Bank of America *v.* Indiana Banking Co., 114 Ill. 483.

drawer of the check had failed.[1] A bank paying a fraudulently altered post-dated check before its true date would not be entitled to charge it against the drawer.[2] Checks are governed by the same rules that bills are, as to demand, protest and notice. A holder of a check, to recover against the drawer, must show a presentment for payment and protest, or that the drawer had no funds in the hands of the drawee.[3] A post-dated check will not be entitled to days of grace, as a bill of exchange.[4] The obligation of the drawee to pay a check and a bill are the same.[5] A bank check has been held to be a bill of exchange, within the meaning of that term as used in the Illinois Statute of Limitations.[6] When payment of a check is made to the payee an indorsement by him is not necessary.[7] Mere priority in drawing a check gives the holder no preference or privity in payment over the holders of checks subsequently drawn.[8] The neglect of the holder of a check to present it will postpone his right to the funds to that of a subsequent attachment upon the funds.[9] A *bona fide* indorsee of a bank check, who had delayed for six months to present it for payment, funds remaining in the hands of the drawee and the drawer, being unprejudiced by the delay, has been held not subjected to equities between the drawer and a previous holder of the check.[10] Presentment and notice are not required where bank checks are

[1] Union Bank *v.* United States Bank, (1807) 3 Mass. 74.

[2] Crawford *v.* Bank, 3 Lancaster Law Rev. (Pa.) 245.

[3] Succession of Kercheval, 14 La. Ann. 457; Barnet *v.* Smith, 30 N. H. 256; Shrieve *v.* Duckham, (1822) 1 Litt. (Ky.) 195; Humphries *v.* Bicknell, 2 Litt. (Ky.) 297; Sutcliffe & Bird *v.* McDowell, 2 Nott & McC. (S. C.) 251; Lilley *v.* Miller, 2 Nott & McC. (S. C.) 257. As to the necessity of proof of presentment and notice of dishonor of a check, to entitle the owner to resort to the drawer for payment, see Case *v.* Morris, 31 Pa. St. 100. Payment of a part of the check after it becomes due by the drawer dispenses with the necessity of such proof. Levy *v.* Peters, 9 Serg. & Rawle (Pa.), 125.

[4] Champion *v.* Gordon, 70 Pa. St. 474; Lawson *v.* Richards, 6 Phil. 179.

[5] City Bank *v.* Girard Bank, 10 La. 566.

[6] Rogers *v.* Durant, 140 U. S. 298. As to the transfer of the sum named in a check to the payee, see Bank of America *v.* Indiana Banking Co., 114 Ill. 483.

[7] Huber *v.* Bossart, (1886) 70 Iowa, 718.

[8] Moses *v.* Franklin Bank of Baltimore, 34 Md. 574. See, also, Norris *v.* Despard, 38 Md. 487.

[9] Harry *v.* Wood, 2 Miles (Pa.), 327; Kuhn *v.* Bank, 20 W. N. C. (Pa.) 230.

[10] Bull *v.* Bank of Kasson, 123 U. S. 105.

payable at a future day or protested.[1] A bank check must be presented for payment by the holder within a reasonable time; should it not be, the delay is at the holder's peril. As to what is a reasonable time would depend upon the circumstances in each case. And the time of presentation may be extended by the assent of the drawer, express or implied. In a Connecticut case, by way of illustration, the plaintiff, desiring to make a remittance to a creditor at a distance, and there being no bank in the place where he lived, asked the defendant, who had an account with a banker in a neighboring city, to take the amount of him in bank bills and give him his check therefor, which the latter did, fully understanding the object. The plaintiff, to whose order the check was payable, at once indorsed it to his creditor and sent it by the next mail. It was three days before the check reached the place where the banker resided, on whom it was drawn, and was presented for payment, at which time the banker had failed and payment was refused. The plaintiff took up the check and brought this action against the drawer. The Supreme Court of Connecticut held that the check was presented within a reasonable time under the circumstances, and held the drawer liable to the drawee for its amount.[2] Negligence cannot be imputed to the holder of a check upon a bank for the payment of money if

[1] Blachly *v.* Andrew, (1855) 1 Disney (Ohio), 78.

[2] Woodruff *v.* Plant, (1874) 41 Conn. 344. The court said: "What is a reasonable time will depend upon circumstances; and will, in many cases, depend upon the time, the mode, and the place of receiving the check, and upon the relations of the parties between whom the question arises. Story on Prom. Notes, § 493; Mohawk Bank *v.* Broderick, 13 Wend. 133. Here three days only elapsed between the giving of the check and its presentment for payment. The particular circumstances attending this case we consider very important. The defendant knew that the plaintiff desired this check to make a remittance; that it was not to be immediately presented for payment, and would not reach the bank for several days. The case of Daggett *v.* Whiting, 35 Conn. 366, is certainly an authority to show that what the understanding of the parties was at the time that the check was drawn and delivered enters into the contract. That the time for presentment may be extended by the assent of the drawer, express or implied, is well settled. Alexander *v.* Burchfield, 7 Man. & Gr. 1061; s. c., 49 Eng. Com. Law Rep. 1060." See on this subject, Bridgeport Bank *v.* Dyer, 19 Conn. 136; Taylor *v.* Wilson, 11 Met. (Mass.) 44; Ames *v.* Meriam, 98 Mass. 294; First Nat. Bank *v.* Harris, 108 Mass. 514; Morrison *v.* Bailey, 5 Ohio St. 13; Stephens *v.* McNeill, 26 Barb. 652; Rickford *v.* Ridge, 2 Campb. 537; Robinson *v.* Hawksford, 9 Adol. & El. (N. S.) 52; Hare *v.* Henty, 10 C. B. (N. S.) 64; Prideaux *v.* Criddle, L. R., 4 Q. B. 455.

he demands payment on the day following that on which he received it. If, however, the holder unreasonably delays in presenting the check for payment, and in the meantime the bank fails, the loss will be the holder's and not that of the drawer of the check.[1] In case it appears that the drawer of a check has sustained any injury by the delay or negligence of the holder of the check in presenting it for payment, the drawer will be discharged from liability.[2] Where a holder of a check had neglected to present it for payment until twenty-five days after it was drawn, during which time the drawer failed, the Supreme Court of Illinois held that the holder of the check could have no recourse upon the drawer unless he showed that no loss occurred to the drawer through his delay in presentation of the check.[3] Where one having funds in a bank gives a check which the holder neglects to present for payment within a reasonable time, the drawer cannot be held liable for non-payment in current funds unless the holder shows not only that the funds on deposit were depreciated at the date of the check, but also that they were depreciated at the time of the deposit, and that, therefore, the drawer had no right to draw the check, or to expect its payment in current funds.[4] The holder of a check will be exercising due diligence when he presents it for payment in accordance with the usage of the banks in the place where it is made payable, and of the persons who have accounts with such banks, provided this usage be lawful and well known or recognized by the mercantile community, and by the parties to the check.[5] One giving a check may expressly, or by implication, extend the time during which he will remain liable for the amount of the check before its presentment for payment.[6] The drawer of a check cannot

[1] Clark *v.* National Metropolitan Bank, 2 MacArthur (D. C.), 249.

[2] Ibid. That the discharge of the drawer of a bank check from liability will result from neglect of the holder to present the same for payment within a reasonable time, and that the doctrine applies to all holders, payees or transferees, see Daniels *v.* Kyle, 5 Ga. 245.

[3] Willetts *v.* Paine, (1867) 43 Ill. 432.

[4] Ibid.

[5] Marrett *v.* Brackett, 60 Me. 524. The holder of a check allowed until the next day after its date to present it. Veazie Bank *v.* Winn, 40 Me. 60. That a check must be presented for payment on its date or the day thereafter where all the parties reside in the same place, see Bank *v.* Weil, 4 Pa. Co. Ct. Rep. 346.

[6] Holmes *v.* Roe, 62 Mich. 199. As to the duty of a bank in the matter of paying the checks drawn upon it by a depositor, see Moses *v.* Franklin Bank of Baltimore, 34 Md. 574. Right of action of a holder of a check against bank refusing payment when drawer

object to any delay in presenting it unless he can show special injury to himself arising from the delay.[1] The drawer of a check will be released by the failure to give him notice of non-payment of the same only to the extent of the injury he may receive thereby. In case of failure of the drawee, then proof of notice of non-payment would be necessary to rebut the presumption of injury arising from the failure; and when the drawer has no funds in the hands of the drawee to meet the check, demand and notice will be necessary.[2] The drawer of a check, if otherwise liable, will not be discharged because of a failure to present the check at the clearing house in accordance with mercantile usage, even though it would have been paid if presented there, when it has been duly presented to the drawee and payment demanded and refused.[3] Four days' delay in presenting a check has been held not too much.[4] A delay in the presentment of a draft, payable on demand, for eleven days has been held not a reasonable time.[5]

has funds in bank. Fogarties *v.* State Bank, 12 Rich. (S. C.) 518. As to a court's preventing the vexatious drawing of small checks against a deposit, see Chicago Marine & Fire Ins. Co. *v.* Stanford, 28 Ill. 168.

[1] Emery *v.* Hobson, 63 Me. 32.

[2] Pack *v.* Thomas, 13 Smedes & Marsh. (Miss.) 11; Graham *v.* Morstadt, (1890) 40 Mo. App. 333.

[3] Kleekamp *v.* Meyer, (1878), 5 Mo. App. 444. When presentment of check to justify an action against the drawer is not necessary, see Cushing *v.* Gore, (1816) 15 Mass. 69; Franklin Bank *v.* Freeman, (1835) 16 Pick. 535. Rules in actions by the holders of checks against the drawers. Ball *v.* Allen, (1819) 15 Mass. 433; Ellis *v.* Wheeler, (1825) 3 Pick. (Mass.) 18.

[4] Piece *v.* Daniel, 16 W. N. C. (Pa.) 35. In St. John *v.* Homans, (1844) 8 Mo. 382, where all the parties to the check resided in the same state, a delay of eight days in presenting the check for payment was held sufficient to discharge the drawer. In Freiberg *v.* Cody, 55 Mich. 108, it appeared that a check for a small sum was given late in the afternoon at a lumber camp, twenty miles from the place where the bank upon which it was drawn was located, to a merchant whose place of business was twenty-seven miles by rail in another direction; and had to be there on the following day, which was Saturday. On Monday he left the check at a local bank for collection, but the bank on which it was drawn failed that day. The court held that the delay in presenting the check for payment was not such as would release the debt for which it was given.

[5] Newark Banking Co. *v.* Bank of Erie, 63 Pa. St. 404. As to reasonable delay in presenting a check for payment, see Chouteau *v.* Rowse, (1874) 56 Mo. 65. As to time within which a check must be paid, see Wear *v.* Lee, (1885) 87 Mo. 358. As to the effect of delay in presentment of a check, see Flemming *v.* Denny, 2 Phil. 111. As to right of action after presentment and demand and failure to pay by drawee with funds of depositors in hand, see McGrade *v.* German Savings Institution, (1877) 4 Mo. App. 336; Zelle *v.* German Savings Institution, (1877) 4 Mo. App. 401; Senter *v.* Continental Bank, (1879) 7 Mo. App. 532; State Savings Assn. *v.* Boatmen's Savings Bank, (1881) 11 Mo. App. 292.

A delay in presenting a check for payment would be excused in case the holder is prevented by any state of things beyond his control from presenting it or sending it to be presented. But in case the delay is protracted to a considerable length of time the reason must be shown.[1] As to what is a reasonable time within which a check was presented may be submitted to the jury under appropriate instructions.[2] Where a drawer has no funds and makes no provision for meeting a check or withdraws his funds before its presentation, he cannot take advantage of a want of diligence in presenting it for payment.[3] The indorser of a check, drawn for his accommodation, who is bound to provide funds to meet it, will not be entitled to notice of non-payment.[4] The custom of banks in doing business among themselves through the clearing house does not alter the rule that a check must be presented to the bank on which it was drawn, at least during banking hours of the next succeeding day.[5] In an action upon a check by the holder against a bank the burden will be upon the holder to show that the sum called for by the check stood to the credit of the drawer when presented.[6] A reply of a bank to which a raised check is sent for information, that it is all right, would be a guaranty of the signature and the state of the drawer's account, and not of the genuineness of the filling in.[7] The indorsement of a raised check is in effect a representation and warranty to the drawee that it is genuine, upon which the drawee may rely in making payment, for reimbursement by the indorser after discovery of the fraud.[8] A bank is entitled to establish that a raised check was a forgery and to recover back the money paid thereon, notwithstanding its recognition and payment, the signature being genuine, under an honest mistake.[9]

§ 328. When a draft on a bank fails to bind the funds in bank.— The United States Supreme Court had before it a case

[1] Moody *v.* Mack, (1869) 43 Mo. 210.

[2] Selby *v.* McCullough, (1887) 26 Mo. App. 66.

[3] Moody *v.* Mack, (1869) 43 Mo. 210; Sterrett *v.* Rosencrantz, 3 Phil. 54.

[4] Williams *v.* Hood, 1 Phil. 205.

[5] Rosenblatt *v.* Habermann, (1880) 8 Mo. App. 486.

[6] International Bank *v.* Jones, 15 Bradw. (Ill.) 594.

[7] Espy *v.* Bank of Cincinnati, 18 Wall. 604.

[8] City Bank *v.* First National Bank, 45 Tex. 203.

[9] National Bank of Commerce *v.* National Mechanics' Bank, (1873) 35 N. Y. Super. Ct. 282; affirmed in 55 N. Y. 211.

in which it appeared that the drawers of a check upon a bank making an assignment for the benefit of creditors just afterwards, immediately gave notice to the bank of this assignment, and requested the bank to hold the funds in its hands for the benefit of the assignee. Virtually, this notice to the bank was prior to the presentation of the check by the payee of the latter, and the bank refused to pay the check. In this action of the payee of the check against the bank for the recovery of the amount of the check, the court held that the check or draft did not bind the funds in the hands of the bank until it had notice of the draft or check by presentation for payment, or otherwise; and that, until then, other checks drawn afterwards might be paid, or other assignments of the fund, or part of it, might secure priority by giving prior notice.[1] A banking firm of Ohio gave its draft or

[1] Laclede Bank *v.* Schuler, (1887) 120 U. S. 511; s. c., 7 Sup. Ct. Rep. 644. Mr. Justice MILLER, speaking for the court, said: "The question of how far and under what circumstances a check of a depositor in a bank will be considered an equitable assignment to the payee of the check of all or any portion of the funds or deposits to the credit of the drawer in the bank, is one which has been very much considered of late years in the courts, and about which there is not a unanimity of opinion. In this court it is very well settled that such a check, unless accepted by the bank, will not sustain an action at law by the drawee against the bank, as there is no privity of contract between them. Marine Bank *v.* Fulton Bank, 2 Wall. 252; Bank of Republic *v.* Millard, 10 Wall. 152; First National Bank of Washington *v.* Whitman, 94 U. S. 343. But while this may be considered as the established doctrine of this court in regard to the rights of the parties at law, and is probably the prevailing doctrine in nearly all the courts, it is urged in this case, and several courts have so decided, that such a check is an appropriation of the amount for which it is drawn of the funds of the drawer in the hands of the bank. Roberts *v.* Austin Corbin & Co., 26 Iowa, 315; Fogarties *v.* State Bank, 12 Rich. Law, 518; s. c., 78 Am. Dec. 468; Munn *v.* Burch, 25 Ill. 35; German Savings Inst. *v.* Adae, 1 McCrary, 501. But however this doctrine may operate to secure an equitable interest in the fund deposited in the bank to the credit of the drawer after notice to the bank of the check, or presentation to it for payment, a question which we do not here decide, we are of opinion that, as to the bank itself, the holder of the fund and its duties and obligations in regard to it, the bank remains unaffected by the execution of such a check until notice has been given to it or demand made upon it for its payment." In Schuler *v.* Laclede Bank, (1886), 27 Fed. Rep. 424, which was affirmed in the case just cited, BREWER, J., disposed of the contentions of the holder of the check in these words: "This question must be solved in a court of equity upon equitable grounds, and I think that it is equitable for a bank, upon the day on which a note becomes due, and at any time during the day, having funds of the maker in its possession, to apply those funds to the payment of that note, although by so doing it leaves nothing standing to the credit of the maker to apply on checks drawn by him. As between the bank, the holder of a note due and the payee of a check upon that bank the equities are in favor of the bank. Or, at least, if the equities are equal, legal title to the funds and possession is with the bank, and it should not be postponed."

check upon a New York bank. They having made an assignment for the benefit of creditors before it was presented to the New York bank, the latter upon presentation refused to pay it, and paid over the funds in its hands to the assignee of the insolvent firm. The holder of the draft or check brought his action against the assignee for the amount. In considering the case brought before them the Supreme Court of Ohio stated, in its opinion, the practical question to be "whether the unaccepted draft for a part only of the amount due the drawer gave the payee or holder priority over the other creditors of the drawer." Their conclusion was that a check or draft for a part only of the sum due the drawer does not, before acceptance, constitute an equitable assignment of the amount for which it is drawn; and where, after it is drawn, the drawer makes an assignment of all his property for the benefit of his creditors, notice of which is received by the drawee before acceptance, the property in the whole amount then remaining to the credit of the drawer passes to the assignee for the equal benefit of all his creditors, and the holder of the check or draft has no priority over the other creditors.[1] The court, later in its opinion, said: "While, how-

[1] Covert *v.* Rhodes, (1891) 48 Ohio St. 66. *Arguendo*, it was said by the court: "Some cases and text writers, we are aware, maintain with much earnestness the position taken by the counsel for the plaintiff, that a draft or bank check for part of the amount due the drawer is an equitable assignment *pro tanto*, giving the payee or holder an equitable property in the fund, which may be pursued as long as it can be certainly identified, except into the hands of third persons who have acquired possession of it for value, and without notice. But the great weight of authority is, we think, the other way. Mr. Pomeroy, in his work on Equity Jurisprudence, section 1284, says that, 'An ordinary bill of exchange or draft drawn generally and not upon any particular fund, whether accepted or not by the drawee, does not operate as an equitable assignment. Its operation is not changed even when funds have been placed in the drawee's hands as a means of payment; for the drawee may apply these funds to another use, and although this act might violate his duty to the drawer, the payee would obtain no interest in or claim upon the specific fund. According to the great preponderance of authority, a check is in this respect a bill of exchange, and does not act as an equitable assignment of a portion of the drawee's deposit equal in amount to the face of the check.' According to the same author, in order that the doctrine of equitable assignment may apply, there must be a

ever, we regard it as well settled that a draft or check for a part only of the drawer's deposit or sum due him does not operate as an equitable assignment, a different rule seems to obtain where an order, draft or check is drawn for the whole amount of the deposit, or the exact sum due. There may be in such cases, it is said, a sufficient designation of the specific fund to be transferred to constitute an equitable assignment." [1] A draft indorsed to a

specific fund upon which the assignment may operate, and 'the sure criterion is whether order or direction to the drawee, if assented to by him, would create an absolute personal indebtedness payable by him at all events, or whether it creates an obligation only to make payment out of the particular designated fund.'" The Ohio court resumed: "The obligation of a bank to its general depositors is not that of bailee or trustee, but that of debtor simply. It does not agree to pay checks or bills drawn on it out of any particular fund; nor does it retain any particular fund for that purpose. As said by Mr. Justice DAVIS in Bank of Republic *v.* Millard, 10 Wall. 152, 155, when deposits are received by the bank, 'unless there are stipulations to the contrary, they belong to the bank, become part of its general fund, and can be loaned by it as other money. The banker is accountable for the deposits which he receives as a debtor, and he agrees to discharge these debts by honoring the checks which the depositor shall from time to time draw on him. The contract between the parties is purely a legal one, and has nothing in the nature of a trust in it.' The authorities are, without exception, to that effect. There is little, if any, conflict of authority upon the proposition that on notice of the drawer's death, before acceptance by the bank, its right to pay the bill or check ceases, and its indebtedness to the drawer becomes assets of his estate. The reason, we apprehend, is not because the bank is the agent of the owner for the disbursement of a particular fund, and the agency is terminated by the death of the principal, but because, before acceptance, the title remains in the drawer, and devolves immediately on his death on his personal representative by operation of law. The authorities are also nearly uniform to the effect that the holder of such draft or check cannot maintain an action against the drawee without the latter's acceptance. The reason given is, that without acceptance there is no privity between them. It would seem clear that if before acceptance, the check or draft operated as an equitable assignment *pro tanto*, such an action might be maintained; for an equitable assignment transfers the fund, and the refusal of the drawee to pay would be a conversion by him of the payee's property, for which suit might at once be brought." The court further cited in support of their views, besides Laclede Bank *v.* Schuler, 120 U. S. 515, Grammel *v.* Carmer, 55 Mich. 201; Dickinson *v.* Coates, Assignee, 79 Mo. 250; Bullard *v.* Randall, 1 Gray, 605; Attorney-General *v.* Continental Life Insurance Co., 71 N. Y. 325; Kimball *v.* Donald, 20 Mo. 577; Loyd *v.* McCaffrey, 46 Pa. St. 410; Chapman *v.* White, 6 N. Y. 412; Dykers *v.* Bank, 11 Paige, 612; Hopkinson *v.* Forster, 19 L. R. (Eq.) 74; Moses *v.* Bank, 34 Md. 574.

[1] Covert *v.* Rhodes, 48 Ohio St. 66. Upon this it was said by the Ohio court: "This distinction is made by many well-considered cases. Among them Moore *v.* Davis, 57 Mich. 251; Bank *v.* Railway Company, 52 Iowa, 378, 384; Mandeville *v.* Welch, 5 Wheat. 277; Kingman *v.* Perkins, 105 Mass. 111; Macomber *v.* Doane, 2 Allen, 541; Robbins *v.* Bacon, 3 Me. 346; Gibson *v.* Cooke, 20 Pick. 15–17. In the opinion of the court in Moore *v.* Davis, 57 Mich. 251, COOLEY, Ch. J., discussing the distinction between the two classes of cases, says: 'In the recent case of Grammel *v.* Carmer, 55 Mich. 201, the question whether a draft was an assignment of the fund in the drawee's hands to the extent of the sum drawn for, was considered and decided in the negative. That, however, was the case of a banker's draft, and it was not drawn for the whole fund in the drawee's hands. Many cases were cited in the opinion filed in that case, and the following, not then cited, are to the same effect: Shand *v.* Du Buisson, L. R., 18 Eq. 283; Lewis *v.* Traders' Bank, 30 Minn. 134; Jones *v.* Pacific Wood Company, 13 Nev. 359; Rosenthal *v.* Martin Bank, 17 Blatchf. 318; Dolsen *v.* Brown, 13 La. Ann. 551; Sands *v.* Matthews, 27 Ala. 399.' COOLEY, Ch. J., then distinguished the cases as follows: 'But this case differs from Grammel *v.* Carmer, 55 Mich. 201, in the fact that the draft now in question was drawn for the exact amount of a sum claimed to be due from the drawee to the owner for a bill of merchandise, and that the account was attached to the draft, evidently for the purpose of being sent forward with it. When thus sent forward it would explain to the drawees the account on which it was drawn, but it must also have been understood to serve a further purpose, namely, to be evidence in the hands of the drawees that the account was paid when the draft was taken up by them. There could be no sufficient reason for attaching it at all, unless it was understood that payment of the draft would be payment of the account as well. By the general commercial law, as was said in Grammel *v.* Carmer, the purchaser of the draft is supposed to take it in reliance upon the responsibility of the drawer, and he has no other reliance until it is accepted. This is the general rule. But if the draft is for the whole amount of a fund the draft may, in connection with other circumstances, tend to show an intent that it should operate as an assignment.'" The Ohio court then concluded as follows: "Gardner *v.* The Natl. City Bank, 39 Ohio St. 600, belongs to this latter class of cases. There the draft was for the exact amount due the drawer, and in the opinion JOHNSON, Ch. J., carefully distinguishes the case from those in which the draft was drawn for a part only of the amount owing by the drawee."

[1] Akin *v.* Jones, (Tenn. 1894) 27 S. W. Rep. 669.

bank for collection, with directions to remit New York exchange, was paid by the drawee overdrawing on the bank receiving it, and the draft canceled. The bank remitted its check for the proceeds, but assigned for the benefit of creditors before the check was paid. The Tennessee Supreme Court held in such case that no trust existed in favor of the payee of the draft, and he was not entitled to any priority of payment over other creditors by the assignee.[1] They also held, there being a contention

contra, that the delivery of a check against a general deposit was not a legal or equitable assignment of any portion of the fund.[1]

§ 329. Forged checks — rules. — One purchasing a forged check and indorsing it, gives it credit and will be liable to the party paying it.[2] The indorsee of a bank check obtains no title to the same where the indorsement is a forgery.[1] Where a bank upon which a check is drawn has paid it to another bank with which it was deposited by one receiving it with an unauthorized indorsement of the name of the payee, the bank may, upon discovery of the facts, recover the money which it has paid irrespective of the question as to whether or not it had been called upon by the drawee to pay the amount again.[2] The fact that the drawee of a check may have brought suit against other persons as fraudulent receiptors will not release a bank which has paid the check upon a forged indorsement.[3] A bank taking drafts with forged indorsements from a person wrongfully in possession of them, collecting and surrendering them to the drawees, would be liable to the owners of the drafts for conversion.[4] The indorsement of the owners, named as payees of these checks, were forged and the checks passed to a third party or value, who deposited them for collection with a bank. The checks were collected by the bank and the proceeds credited to this third party. The court held that a joint and several action was maintainable by the owners of the checks against this party and the bank for the proceeds of the checks.[5] A depositor in a bank, who, being deceived by his clerk, drew a check in favor of a customer, and his clerk forging an indorsement of the payee's name on which the bank paid the check, has been held not to be precluded from disputing the bank's right to charge the check to his account because of entry of the check in his pass book, its return by the bank with the vouchers, and retention by the depositor, without objection for several months.[6] It is not the duty of a bank depositor to examine his pass book or returned checks with a view to detect forgeries in the indorsements. He may assume that the bank ascertained the genuineness of the indorsements before payment.[7] A bank is bound also to ascertain the genuineness of an indorsement upon a check, and a drawee of

[1] Akin *v.* Jones, (Tenn. 1894) 27 S. W. Rep. 669. It was said by the court: "The case of Imboden *v.* Perrie, 13 Lea, 504, involved more of the features presented in this case than any other reported in this state. In that case the question arose between creditors. One creditor held a check of the debtor against a general deposit of the debtor in bank, while the other was an attachment creditor of that fund. The question was fairly raised in that case whether the check worked an equitable assignment of the fund in bank to the checkholder before the presentation of the check or notice to the bank. If so, the check-holding creditor was entitled to priority. If not, then the attachment had priority. Judge TURNEY, in delivering the opinion of the court against the defendant's theory of equitable assignment, cited approvingly the opinion of Chief Justice CHURCH in Attorney-General *v.* Continental Life Ins. Co., 71 N. Y. 325, to the effect that checks drawn in the ordinary form, not describing any particular fund or using any words of transfer of the whole, or any part of any amount standing to the credit of the drawer, but containing only the usual request, are of the same effect as inland bills of exchange, and do not amount to an assignment of the funds of the drawer in bank. 'This doctrine,' he continues, 'accords with the relations between the parties. Banks are debtors to their customers for the amount of their deposits. A check is a request of the customer to pay the whole or a portion of such indebtedness to the bearer or to the order of the payee. Until presented and accepted, it is inchoate. It vests no title, legal or equitable, in the payee to the fund. Before acceptance the drawer may withdraw his deposits. The bank owes no duty to the holder until the check is presented for payment. Knowledge that checks have been drawn does not make it obligatory upon the bank to retain the deposits to meet them. These rules are indispensable to the safe transaction of commercial business. * * *' The case of Attorney-General *v.* Continental Life Ins. Co., 71 N. Y. 325, * * * presented the exact state of facts found in this record. In that case the insurance company gave its check upon a trust company in payment of a loss, the company having at the time on deposit a sum exceeding the amount of the check, but prior to its presentation a receiver of the insurance company was appointed who withdrew all the funds deposited with the trust company. In an action by this checkholder against the receiver to recover the whole amount of the check out of the funds in his hands, it was held by the Court of Appeals of New York that the check, not having been drawn upon a particular fund, was not an equitable assignment *pro tanto* of a general deposit, and that the checkholder was not entitled to payment in full in preference to the claims of other creditors." See, also, Risley *v.* Bank, 83 N. Y. 318; Ætna Nat. Bank *v.* Fourth Nat. Bank, 46 N. Y. 87.

[2] Merchants' Bank *v.* Exchange Bank, 16 La. 457.

[1] Indiana National Bank *v.* Holtsclaw, (1884) 98 Ind. 85.

[2] Central National Bank *v.* North River Bank, (1887) 44 Hun, 114.

[3] August *v.* Fourth National Bank, (Sup. Ct. 1888) 15 N. Y. St. Repr. 956.

[4] People *v.* Bank of North America, (1879) 75 N. Y. 547.

[5] White *v.* Mechanics' National Bank, (1871) 4 Daly, 225.

[6] Welsh *v.* German-American Bank, (1878) 73 N. Y. 424; s. c., 29 Am. Rep. 175.

[7] Ibid. See, also, Bank of British North America *v.* Merchants' National Bank of New York, (1881) 13 N. Y. Wkly. Dig. 374.

a check, payable to the order of the payee, will not be bound by a payment made by the bank on a forged indorsement of the payee's name.[1] The responsibility of the drawee, who pays a forged check, for the genuineness of the drawer's signature, is absolute only in favor of one who has not by his own fraud or negligence contributed to the success of the fraud or to mislead the drawee. So, if a payee take a check drawn payable to his order, from a stranger or other third person, without inquiry, although in good faith and for value, and give it currency and credit by indorsing it before securing payment of it, the drawee may recover back the money paid on it.[2] In case a bank has paid out a depositor's money on forged checks, the fact that the depositor may have obtained collateral security to reimburse him for the acts of the forger, would be no reason why a recovery may not be had of the bank, where nothing has been realized out of the security.[3] If the drawee of a bank check pays a forged check to the holder, he will not be entitled to recover back the money so paid, where there has been no fraud practiced upon him.[4] But the drawee or payer of a forged bank check may

[1] Welsh *v.* German-American Bank, (1878) 73 N. Y. 424; s. c., 29 Am. Rep. 175. That a bank pays a check, the signature of which is forged, at its peril, see Frank *v.* Chemical National Bank of New York, (1881) 84 N. Y. 209, affg. 45 N. Y. Super. Ct. 452. In Mackintosh *v.* Eliot Bank, (1877) 123 Mass. 393, the bank which had paid out money on a check purporting to be signed by one of its depositors, but the signature on which was in fact forged by the depositor's clerk, was held, in the absence of evidence that that the clerk had or was supposed by the bank to have any authority to sign the depositor's name, not exempt from liability to the depositor by proof that the forgery was committed on a blank form taken from the depositor's check book, which was left lying about in his office during the day; that the check was stamped with a hand stamp sometimes used on his checks, and which was accessible to any one in his office; that the clerk was allowed to fill up checks, and was introduced by the depositor to the officers of the bank as the person who was authorized to receive money on the depositor's checks.

[2] North America Bank *v.* Bangs, (1871) 106 Mass. 441. In Belknap *v.* North America Bank, (1868) 100 Mass. 376, a drawer of a check payable to A. B. or order, who sent it by his clerk to the post office to be mailed inclosed in a sealed letter, was held not guilty of negligence which would render him liable on the check in the hands of the holder in good faith for value, to whom the clerk, after abstracting it from the letter, passed it altered by forging the words "or bearer" after A. B. and before "or order," and obliterating the latter words.

[3] Bank *v.* Green, 3 Pennypacker (Pa.), 456. As to a bank paying a forged check and being bound to know the signature of its depositors, see Commercial & Farmers' National Bank *v.* First National Bank, 30 Md. 11.

[4] First National Bank of Quincy *v.* Ricker, (1874) 71 Ill. 440. The court said: "Bankers are supposed to have a better opportunity to know the signatures of their depositors to checks than a drawee that of a single correspondent whose bills are drawn with less frequency, and are, perhaps, held to a higher degree of diligence in that regard. The principles applicable to checks and to bills are regarded as sufficiently analogous to make a decision rendered upon one instrument a precedent for a case arising on the other. Hence, we find the case of Price *v.* Neal, 3 Burr. 1354, is referred to in nearly or quite all the decisions on this question. That was an action to recover back money paid on two forged bills. It was declared the plaintiff could not recover for the reason the defendant had received the money on the bills indorsed to him for a valuable consideration without any suspicion of forgery, and that it was incumbent on the plaintiff to be satisfied the bill drawn on him was in the drawer's hand before he accepted or paid it, but it was not incumbent on the defendant to inquire into it. The doctrine of this case, so far as it holds the drawee is bound to know the handwriting of his correspondent, when applied to the case of a bill accepted or paid by him, where the drawer's name has been forged, has seldom, if ever, been departed from. It is said to have its foundation in a sound public policy, and considerations of convenience in commercial transactions make it imperative it shall be enforced. The general rule, no doubt, has its exceptional cases, and the doctrine as stated by Lord MANSFIELD in Price *v.* Neale, has certainly been very much limited by more modern decisions. The difficulty does not lie in the general rule itself, for it is undoubtedly supported by reason and the weight of authority, but in its application to particular cases only."

recover the amount paid by him on it, where the holder or payee is himself at fault, or has been guilty of fraudulent practices which may have thrown the drawee off his guard.[1] The court further held that where the holder of a forged check presented it to the drawee, and received payment on it, and withheld knowledge which he then possessed of facts which rendered it morally certain that the check was a forgery, he was not in a position to set up, in this suit brought to recover back the money, that the drawee was obliged to know the signature of his own depositors, and that he was estopped to say that he was mistaken.[2] Should

[1] First National Bank of Quincy *v.* Ricker, (1874) 71 Ill. 439. It appeared in this case that the holder of the forged check, which he had received and paid for without knowing that it was a forgery, after acquiring knowledge of facts calculated to arouse suspicion that it was a forgery, presented it at the bank on which it was drawn and demanded payment, without disclosing the facts which aroused his suspicion; he was told by the teller of the bank that he did not certainly know the signature to the check, and would only pay it on condition that the holder would indorse it; thereupon the holder did indorse it and received the money on it, and the bank, within a few hours, discovered the forgery and then ordered that the money be refunded. The court held that the drawee could recover the money paid under this state of facts.

[2] First National Bank of Quincy *v.* Ricker, (1874) 71 Ill. 439. The court also said: "It is contended there is no

a savings bank pay out money on a forged order, without requiring a compliance with the by-laws printed in a depositor's pass book, the payment would be in its own wrong, though the pass book may have been produced at the time.[1] If, however, it

duty resting on the innocent holder of a check, on presenting it for payment, to communicate to the bank suspicions he may have as to its spurious character, if at the time he took it he had no reason to suspect it was a forgery. The cases of The Bank of St. Albans *v.* The Farmers' Bank, 10 Vt. 141, and Ward *v.* Allen, 2 Met. (Mass.) 53, are cited in support of this proposition. We have looked into these cases, but we do not think they sustain the doctrine to the extent asserted. While we have the highest respect for the courts that rendered those decisions, we must be permitted to express our dissent from the principle insisted upon, as being unsound in law and in good conduct. No warrant can be found for its introduction in the exigencies of banking or commercial transactions. Such a doctrine, in our opinion, would tend rather to debase than maintain commercial integrity. Where exceptional circumstances and excusing facts are made clearly to appear, courts have permitted a recovery, and in some instances very slight palliating circumstances have been declared sufficient. The case of Wilkinson *v.* Johnson, 3 B. & C. 428, is a well-reasoned case on this point. The case of Goddard *v.* Bank, 4 Comst. (N. Y.) 147, is a still stronger case illustrative of the exceptions to the general rule. In that case the plaintiffs were informed a draft had been drawn by their correspondent, a bank in Ohio, on the American Exchange Bank at New York, which had been protested, and was then in the hands of the notary. The plaintiff called to see the notary about taking up the draft, but, owing to his absence, did not see the draft. On this information the plaintiffs acted, and supposing his correspondent (the Canal Bank) had, by mistake, drawn on the Exchange Bank with which it had just before kept an account, instead of drawing on the plaintiffs, and wishing to protect the credit of the drawer, he left a check with a party in the office, to be delivered to the notary, to take up the draft, and gave directions to have it sent to his office that day. The notary took the check and paid the money to the defendants, but failed to send the draft as requested. When the plaintiff called the next day on the notary for the draft, on its production he immediately pronounced it a forgery, and thereupon went to the defendant bank and demanded the money back. On this state of facts the plaintiffs were permitted to recover on the ground they were guilty of no negligence, as the notary, when he received the check, and handed it over to the defendant, both he and they honestly affirmed the draft was genuine. In McKleroy *v.* Southern Bank of Kentucky, 14 La. Ann. 458, while admitting the full force of the general rule, it was, nevertheless, ruled, where a party becomes the holder of a forged draft before it had been accepted, and the loss had already attached before payment by the acceptors, who immediately, on ascertaining the spurious character of the paper, gave notice to the holder, such a case was an exception to the general rule, and the acceptors were not estopped from proving the forgery and recovering the money back. The principle upon which the case is decided is, the holder had suffered no loss, it having already occurred, and he ought not to be permitted to profit by the mere accident of payment."

[15] Bank *v.* Cupps, 91 Pa. St. 315.

should make a payment on such an order in strict accordance with such by-law, the depositor would be bound by it.[1]

§ 330. Payment of forged checks or payment of checks on forged indorsements.— In view of the relation between the banks and their depositors and of their rights and obligations, the principle is universally maintained that banks and bankers are bound to know the signatures of their own customers, and that they pay checks purporting to be drawn by them at their peril.[2] Where a bank, holding deposits, subject to checks, pays a forged check, it will be liable for the amount, with legal interest from judicial demand.[3] If, when the bank book of a depositor is balanced and returned to him together with the canceled checks or vouchers, he has knowledge of facts from which he could, by the exercise of reasonable care and inquiry, have discovered forgeries, and if, owing to his failure to make the discovery and communicate it, the bank suffers loss or is placed in a worse position than it would otherwise have occupied, the depositor would lose his right to recover money paid by the bank on forged indorsements of his checks.[4] Such loss or disadvantage to the bank would not be presumed; it would be required to prove it. Unless it be affirmatively shown, the depositor would not be estopped to recover the amount of such payments.[5] A bank having paid a check drawn upon it cannot recover the money from the person

[1] Burrill *v.* Bank, 92 Pa. St. 134. As to the effect of payment of a check upon a forged indorsement, see Dodge *v.* National Exchange Bank, (1870) 20 Ohio St. 235.

[2] Commercial & Farmers' Nat. Bank *v.* First National Bank, 30 Md. 11.

[3] Laborde *v.* Consolidated Association, 4 Rob. (La.) 190; Etting *v.* Commercial Bank, 7 Rob. (La.) 459.

[4] Wind *v.* Fifth National Bank, (1889) 39 Mo. App. 72.

[5] Ibid. In Smith *v.* Mechanics' Bank, 6 La. Ann. 611, the facts were that a broker discounted at the usual rate, but without inquiry, for an entire stranger, a bill, purporting to be drawn by a planter, and accepted by a well-known house in New Orleans, and indorsed in blank by an unknown payee, presumed to be fictitious. The names of the drawer and acceptor were forged. In payment, the broker gave upon a bank, of which he had for many years been a customer, a check to the order of the acceptors. The names of the acceptors were again and very badly forged on the check, and the check was presented to the bank and paid. The broker had generally drawn his checks to the order of those for whom he discounted, though there was no understanding between him and the bank as to the mode of their business. The acceptors were not customers of the bank, in which, however, they paid large amounts of their paper. No relations whatever existed between the broker and the acceptors. The Supreme Court of

to whom it was paid on the ground that the check was a forged one.[1] The facts that a forged check was written on one of the depositor's own blanks taken from his book, and that the depositor had furnished his signature to the forger and had grounds of suspicion, have been held to be no reasons for holding the depositor liable for a payment made by the bank upon a forged check.[2] Checks drawn payable to the order of plaintiff, in a New York case, coming into the hands of their clerk, he fraudulently indorsed their names and transferred the checks to other parties and appropriated the money received from them to his own use. Subsequently, the checks were deposited in a bank, the money collected by the bank and paid to their depositors. It was held that the plaintiffs were entitled to recover the amount collected by the bank in their action against it.[3] The fact that a depositor receives, under a mistake as to the fact of payment, a check paid upon a forged indorsement of the name of the payee, as one properly paid and charged to his account, will not deprive him of his right to recover the amount of the check from the bank which has paid it.[4] If a bank pays money on a forged check, no matter under what circumstances of caution, or however honest the belief in its genuineness, if the depositor himself be free of blame, and has done nothing to mislead the bank, all the loss must be borne by the bank for it acts at its peril, and pays out its own funds, and not those of the depositor.[5] A depositor is simply bound to

Louisiana held that the bank, although itself grossly negligent, was entitled to charge the broker's check to his debit in account. The court was divided, and the justices each discussed the questions involved very fully and interestingly in their several opinions.

[1] National Bank of the Commonwealth *v.* Grocers' National Bank, (1867) 2 Daly, 289; s. c., 35 How. Pr. 412.

[2] Leavitt *v.* Stanton, Hill & D. Supp. 413.

[3] Johnson *v.* First National Bank of Hoboken, (1875) 6 Hun, 124. As to payment of forged checks, see Stuyvesant Bank *v.* National Mechanics' Banking Association, (1872) 7 Lans. 197; Allen *v.* Fourth National Bank of New York, (1874) 37 N. Y. Super. Ct. 137; affirmed in 59 N. Y. 12.

[4] Bank of British North America *v.* Merchants' National Bank of New York, (1883) 91 N. Y. 106, affirming 48 N. Y. Super. Ct. 1. See, also, Thomson *v.* Bank of British North America, 82 N. Y. 1. That a bank paying a certificate of deposit upon a forged indorsement of the payee may recover the amount from the bank through which it had passed for collection, see Merchants' Bank *v.* Marine Bank, 3 Gill (Md.), 96. That a bank is not bound by the admission of its cashier that a forged bill is genuine, see Merchants' Bank *v.* Marine Bank, 3 Gill (Md.), 96.

[5] Hardy & Bros. *v.* Chesapeake Bank, (1879) 51 Md. 562, 585.

refrain from doing any act that would reasonably have the effect of misleading the bank to its hurt or injury, and not fail to do any act that positive duty requires him to do for the protection of the bank. Should a bank account be balanced on the depositor's bank book, and the book and canceled checks returned to the depositor, after the lapse of a reasonable time, within which the checks and account might be compared, without objection being made, a presumption will arise that the account as balanced and the checks charged in the account are correct. This presumption proceeds upon the ground simply of an implied admission, and is only *prima facie* in its effect.[1] It arises from the natural and usual habits of careful business men to examine and scrutinize such accounts when rendered; but it is liable to be repelled by showing that the error or fraud complained of was not discoverable by the exercise of reasonable care and diligence, or that there was no such appearance of things as to excite the suspicion of a reasonable man, or that, for any reason, the depositor had not had an opportunity to examine the accounts.[2] If a depositor who is in the habit of drawing checks upon his deposit account, should, by word or acts, cause the bank, the latter acting upon such reasonable grounds as prudent business men generally act, to make payment on a forged check, the depositor would not be allowed, as against the bank, to set up the forgery that he, by his conduct, had induced the bank to act on as a genuine check.[3] Where on a forged indorsement a bank has paid a check, the bank is not responsible to the drawer where the person who committed the forgery is identified to the bank by one who believes him to be the payee, and is in fact the person to whom the drawer had delivered the check, and whom he believes to be the payee. And should the drawer of such a check, for more than a month after discovering that it had been paid upon a forged indorsement, neglect to notify the bank that he will hold it responsible therefor, the bank will be released from liability even though it had notice of the forgery as soon as the drawer had.[4] In a depositor's suit against a bank in Maryland, some of the checks paid by the bank were forged by a confidential clerk intrusted by

[1] Wiggins *v.* Burkham, 10 Wall. 129.

[2] Weisser *v.* Denison, 10 N. Y. 68, 76; National Bank *v.* Whitman, 94 U. S. 343, 346.

[3] Hardy & Bros. *v.* Chesapeake Bank, (1879) 51 Md. 562, 586.

[4] United States *v.* National Exchange Bank, (1891) 45 Fed. Rep. 163. As sustaining the first point, see Gloucester Bank *v.* Salem Bank, 17 Mass. 33; Bank of U. S. *v.* Bank of Georgia, 10 Wheat. 333; Price *v.* Neal,

them to make the entry of all checks in their bank book. In making the fraudulent entry of these forged checks in the depositor's bank book the Court of Appeals held that he was not the agent of his employers for any such purpose; also, that the clerk's fraudulent knowledge in regard to acts and transactions outside of and beyond his employment could not be imputed to his principal. The court also held that in this case the jury should have been required to find either that the depositors had knowledge in fact that the forgeries had been committed, or that, from carelessness and indifference to the rights of others, they failed to inform themselves from sources of information readily accessible to them, and which, by the exercise of ordinary diligence of business men, would have disclosed to them the fact that the forgeries had been committed. If such facts were found to exist, then it must be also found, in order to work an estoppel upon the depositor to claim that the checks paid were forged, that the bank acted in honoring and paying forged checks presented after other forged checks had been returned with the balanced bank books to the depositors, in reference to the conduct of the latter in failing to make known an objection to the account, as stated and balanced in the bank book so returned, and that such omission and neglect of the depositors did in fact mislead the bank into the error of paying the forged checks presented after the other forged checks had been returned with the balanced bank book to the bank. The court distinguished De Feriet *v.* Bank of America, 23 La. Ann. 310, in these words: "There, when the first check was forged by the plaintiff's confidential clerk, and paid by the bank, the plaintiff was notified of the draft upon his account and went at once to the bank, and upon being shown the

3 Burr. 1355. As sustaining the second point, see Redington *v.* Woods, 45 Cal. 406; Cooke *v.* United States, 91 U. S. 396; United States *v.* Bank, 6 Fed. Rep. 134. It appeared in the case of Wells, Fargo & Co. *v.* United States, (1891) 45 Fed. Rep. 337, that a pension check, drawn by mistake for $1,280.20 instead of $18, was indorsed by the payee to a bank, and by that bank indorsed for collection to another which indorsed it to the assistant treasurer of the United States, who paid it. The assistant treasurer retained out of money due the collecting bank from the United States the amount of the check. In this action by the collecting bank against the United States for the money retained by the assistant treasurer, it was held that the money collected by the collecting bank upon the pension check which it had paid over to its principal, the forwarding bank, could not be recovered from the collecting bank, and the latter, therefore, could recover the money due it which had been retained from the United States.

check, while he stated that he had not signed the check himself, he refused to denounce it as a forgery. After seeing the clerk, the plaintiff reported back to the bank that the check was all right. The clerk made deposits to make the check good, and the plaintiff himself drew upon the deposits thus made. He continued the forger in his employ; and, subsequently, the same clerk forged another check which the bank paid; and, upon discovery of the second forgery, the plaintiff denounced it. But it was held that, by his conduct in ratifying the act of the clerk in drawing the first forged check, the plaintiff was precluded from holding the bank liable for the payment of the second; that the bank was misled by the approval and ratification of the first forgery, and that it was, therefore, excusable for paying the second forged check drawn in all respects similar to the first. In that case there was no question as to the want of knowledge on the part of the plaintiff of the first forgery committed by the clerk, and his full ratification and adoption of the act, nor was there any in regard to the fact that the bank had been misled."

§ 331. Payment of raised checks.— The United States Supreme Court reversed the judgment of the Circuit Court in favor of a depositor against a bank, holding that a depositor in a bank, who sends his pass book to be written up and receives it back with entries of credits and debits and his paid checks as vouchers for the latter, is bound personally or by an authorized agent, and with due diligence, to examine the pass book and vouchers, and to report to the bank, without unreasonable delay, any errors which may be discovered in them; and if he fails to do so, and if the bank is thereby misled to its prejudice, he cannot afterwards dispute the correctness of the balance shown by the pass book. Further, it held that if a depositor in a bank delegates to a clerk the examination of his written-up pass book and paid checks returned therewith as vouchers, without proper supervision of the clerk's conduct in the examination, he does not so discharge his duty to the bank as to protect himself from loss, if it turns out that without his knowledge the clerk committed forgery in raising the amounts of some of those checks, and thereby misled the bank to its prejudice, in spite of due care on the part of its officers.[1]

[1] Leather Manufacturers' Bank *v.* Morgan, (1886) 117 U. S. 96. In a well and fully considered opinion, Harlan, J., for the court reviewed

the leading cases pertinent to the questions before the court, and declared the law in such cases in the following words: "While it is true that the relation of a bank and its depositor is one simply of debtor and creditor (Phœnix Bank *v.* Risley, 111 U. S. 125, 127), and that the depositor is not chargeable with any payments except such as are made in conformity with his orders, it is within common knowledge that the object of a pass book is to inform the depositor from time to time of the condition of his account as it appears upon the books of the bank. It not only enables him to discover errors to his prejudice, but supplies evidence in his favor in the event of litigation or dispute with the bank. In this way it operates to protect him against the carelessness or fraud of the bank. The sending of his pass book to be written up and returned with the vouchers, is, therefore, *in* effect, a demand to know what the bank claims to be the state of his account. And the return of the book, with the vouchers, is the answer to that demand, and, in effect, imports a request by the bank that the depositor will, in proper time, examine the account so rendered, and either sanction or repudiate it. In Devaynes *v.* Noble, 1 Meriv. 530, 535, it appeared that the course of dealing between banker and customer, in London, was the subject of inquiry in the High Court of Chancery as early as 1815. The report of the master stated, among other things, that for the purpose of having the pass book 'made up by the bankers from their own books of account, the customer returns it to them from time to time as he thinks fit; and, the proper entries being made by them up to the day on which it is left for that purpose, they deliver it again to the customer, who thereupon examines it, and, if there appears any error or omission, brings or sends it back to be rectified; or, if not, his silence is regarded as an admission that the entries are correct.' This report is quite as applicable to the existing usages of this country as it was to the usages of business in London at the time it was made. The depositor cannot, therefore, without injustice to the bank, omit all examination of his account, when thus rendered at his request. His failure to make it, or to have it made, within a reasonable time after opportunity given for that purpose, is inconsistent with the object for which he obtains and uses a pass book. It was observed in First National Bank *v.* Whitman, 94 U. S. 343, 346— although the observation was not, perhaps, necessary in the decision of the case — that the ordinary writing up of a bank book, with a return of vouchers or statement of accounts, precludes no one from ascertaining the truth and claiming its benefit. Such undoubtedly is a correct statement of a general rule. It was made in a case where the account included a check, in respect to which it was subsequently discovered that the name of the payee had been forged. But it did not appear that either the bank or the drawer of the check was guilty of negligence. The drawer was not presumed to know the signature of the payee; his examination of the account would not necessarily have disclosed the forgery of the payee's name; therefore, his failure to discover that fact sooner than he did was not to be attributed to want of care. Without impugning the general rule that an account rendered which has become an account stated, is open to correction for mistake or fraud (Perkins *v.* Hart, 11 Wheat. 237, 256; Wiggins *v.* Burkham, 10 Wall. 129, 132), other principles come into operation, where a party to a stated account, who is under a duty, from the usages of business or otherwise, to examine it within a reasonable time after having an opportunity to do so, and give timely notice of his objections thereto, neglects altogether to make such examination himself, or to have it made, in good faith, by another for him, by reason of which negligence, the other party relying upon the account as having been acquiesced in or approved, has failed to take steps for his protection which he could and would have taken had such notice been given. In other words, parties to a stated account may be estopped by their conduct from questioning its correctness." After some discussion of the doctrine of estoppel and the citation of cases bearing upon the doctrine, it is said: "Upon this doctrine substantially rests the decision in Bank of United States *v.* Bank of Georgia, 10 Wheat. 333, 343, where the question was as to the right of the Bank of Georgia to cancel a credit given to the Bank of the United States in the general account the latter kept with the former for the face value of certain bank notes, purporting to be genuine notes of the Bank of Georgia, and which came to the hands of the other bank in the regular course of business and for value. The notes were received by the Bank of Georgia as genuine, but being discovered nineteen days thereafter to be counterfeits, they were tendered back to the Bank of the United States, which refused to receive them. The court held that the loss must fall upon the Bank of Georgia. Mr. Justice Story, who delivered the opinion of the court, after observing that the notes were received and adopted by the Bank of Georgia as its genuine notes, and treated as cash, and that the bank must be presumed to use reasonable care, by private marks and otherwise, to secure itself against forgeries and impositions, said: 'Under such circumstances, the receipt by a bank of forged notes, purporting to be its own, must be deemed an adoption of them. It has the means of knowing if they are genuine; if these means are not employed it is certainly evidence of a neglect of that duty which the public have a right to require. And in respect to persons equally innocent, where one is bound to know and act upon his knowledge, and the other has no means of knowledge, there seems to be no reason for burdening the latter with any loss in exoneration of the former. There is nothing unconscientious in retaining the sum received from the bank, in payment of such notes, which its own acts have deliberately assumed to be genuine. If this doctrine be applicable to ordinary cases, it must apply with greater strength to cases where the forgery has not been detected until after a considerable lapse of time. Even,' he added, 'in relation to forged bills of third persons received in payment of a debt, there has been a qualification engrafted on the general doctrine that the notice and return must be within a reasonable time; and any neglect will absolve the payor from responsibility.' It was, therefore, held that, as the Bank of Georgia could by ordinary circumspection have detected the fraud, it must account to its depositor according to the entry made in its books at the time of receiving the notes. Further on it was said: This court, in the [cases Bank of United States *v.* Bank of Georgia, 10 Wheat. 333, and Cooke *v.* United States, 91 U. S. 389, recognizing the same principle] refers, with approval, to Gloucester Bank *v.* Salem Bank, 17 Mass. 33, 42. In that case it appeared that the Salem Bank exchanged with the Gloucester Bank, for value, certain bank notes which purported to be, and which both banks at the time believed to be, the genuine notes of the Gloucester Bank, and which the latter bank did not, until about fifty days after the exchange, discover to be forgeries. The question was whether the Salem Bank was bound to account for the

value of the notes so ascertained to be counterfeit. Chief Justice PARKER, speaking for the whole court, observed that the parties being equally innocent and ignorant, the loss should remain where the chance of business had placed it, and that in all such cases the just and sound principle of decision was that if the loss can be traced to the fault or negligence of either party, it should be fixed upon him. He said: 'And the true rule is that the party receiving such notes must examine them as soon as he has opportunity, and return them immediately. If he does not, he is negligent; and negligence will defeat his right of action. This principle will apply in all cases where forged notes have been received, but certainly with more strength where the party receiving them is the one purporting to be bound to pay. For he knows better than any other whether they are his notes or not, and if he pays them, or receives them in payment, and continues silent after he has had sufficient opportunity to examine them, he should be considered as having adopted them as his own.' These cases are referred to for the purpose of showing some of the circumstances under which the courts, to promote the ends of justice, have sustained the general principle that where a duty is cast upon a person, by the usages of business or otherwise, to disclose the truth — which he has the means, by ordinary diligence, of ascertaining — and he neglects or omits to discharge that duty, whereby another is misled in the very transaction to which the duty relates, he will not be permitted, to the injury of the one misled, to question the construction rationally placed by the latter upon his conduct." The court then applied the principle just referred to to the facts in this case, and said: "It seems to us that if the case had been submitted to the jury, and they had found such negligence upon the part of the depositor as precluded him from disputing the correctness of the account rendered by the bank, the verdict could not have been set aside as wholly unsupported by the evidence. In their relations with depositors, banks are held, as they ought to be, to rigid responsibility. But the principles governing those relations ought not to be so extended as to invite or encourage such negligence by depositors in the examination of their bank accounts, as is inconsistent with the relations of the parties or with those established rules and usages sanctioned by business men of ordinary prudence and sagacity, which are or ought to be known to depositors. We must not be understood as holding that the examination by a depositor of his account must be so close and thorough as to exclude the possibility of any error whatever being overlooked by him. Nor do we mean to hold that the depositor is wanting in proper care when he imposes upon some competent person the duty of making that examination and of giving timely notice to the bank of objections to the account. If the examination is made by such an agent or clerk in good faith and with ordinary diligence, and due notice given of any error in the account, the depositor discharges his duty to the bank. But when, as in this case, the agent commits the forgeries which misled the bank and injured the depositor, and, therefore, has an interest in concealing the facts, the principal occupies no better position than he would have done had no one been designated by him to make the required examination, without, at least, showing that he exercised reasonable diligence in supervising the conduct of the agent while the latter was discharging the trust committed to him. In the absence of such supervision, the mere designation of an agent to discharge a duty resting primarily upon the principal, cannot be deemed the equivalent of performance by the latter. While no rule can be laid down that will cover every transaction between a bank and its depositor, it is sufficient to say that the latter's duty is discharged when he exercises such diligence as is required by the circumstances of the particular case, including the relations of the parties, and the established or known usages of banking business." The court, referring to Weisser *v.* Denison, 10 N. Y. 68, 70; Welsh *v.* German-American Bank, 73 N. Y. 424; Frank *v.* Chemical Bank, 84 N. Y. 209, 213, which showed a settled course of decision in the highest court of the state of New York sustaining the grounds upon which the Circuit Court proceeded in giving its judgment, said: "There are, it must be conceded, some expressions in the first two cases which, at first glance, seem to justify the position of counsel. But it is to be observed, in reference to the case of Weisser *v.* Denison, that it is said in the opinion of the court that, as the bank had not taken any action, nor lost any rights, in consequence of the silence of the depositor, the only effect of such silence was to cast the burden upon him to show fraud, error or mistake in the account rendered by the bank. From Welsh *v.* German-American Bank, it is clear that the comparison by the depositor of his check book with his pass book would not necessarily have disclosed the fraud of his check, for the check when paid by the bank was, in respect of date, amount, and name of payee, as the depositor intended it to be, and the fraud was in the subsequent forgery by the clerk of the payee's name. As the depositor was not presumed to know, and as it did not appear that he in fact knew, the signature of the payee, it could not be said that he was guilty of negligence in not discovering, upon receiving his pass book, the fact that his clerk, or some one else, had forged the payee's name in the indorsement. The latest expression of the views of the Court of Appeals of New York is in Frank *v.* Chemical National Bank. From what is there said it is evident that that learned tribunal does not give its sanction to the broad proposition that a depositor who obtains periodical statements of his account, with the vouchers, is under no duty whatever to the bank to examine them, and give notice, within a reasonable time, of errors discovered therein. The court in that case, speaking by Judge ANDREWS, who delivered the opinion in Welsh *v.* German-American Bank, refers to Weisser *v.* Denison. After observing that it was unnecessary to restate the ground of that decision, and adverting to the argument that where a pass book was kept, which was balanced from time to time and returned to the depositor, with the vouchers for the charges made by the bank, including forged checks, the latter is under a duty to the bank to examine the account and vouchers, with a view to ascertain whether the account is correct, he proceeds: 'It does not seem to be unreasonable, in view of the course of business and the custom of banks to surrender their vouchers on the periodical writing up of the accounts of depositors, to exact from the latter some attention to the account when it is made up, or to hold that the negligent omission of all examination may, when injury has resulted to the bank, which it would not have suffered if such examination had been made and the bank had received timely notice of the objections, preclude the depositor from afterwards questioning its correctness. But where bogus checks have been paid and charged in the account and returned to the depositor,

he is under no duty to the bank to so conduct the examination that it will necessarily lead to the discovery of the fraud. If he examines the vouchers personally, and is himself deceived by the skillful character of the forgery, his omission to discover it will not shift upon him the loss which, in the first instance, is the loss of the bank. Banks are bound to know the signatures of their customers, and they pay checks purporting to be drawn by them at their peril. If the bank pays forged checks it commits the first offense. It cannot visit the consequences upon the innocent depositor, who, after the fact, is also deceived by the simulated paper. So, if the depositor, in the ordinary course of business, commits the examination of the bank account and vouchers to clerks or agents, and they fail to discover checks which are forged, the duty of the depositor to the bank is discharged, although the principal, if he had made the examination personally, would have detected them. The alleged duty, at most, only requires the depositor to use ordinary care; and if this is exercised, whether by himself or his agents, the bank cannot justly complain, although the forgeries are not discovered until it is too late to retrieve its position or make reclamation from the forger.' The court distinguished Manufacturers' National Bank *v.* Barnes, 65 Ill. 69, to which they were referred in behalf of the depositor. Afterwards there was a reference to other cases, as follows: 'An instructive case is that of Dana *v.* Bank of the Republic, 132 Mass. 156, 158, where the issue was between a bank and its depositor in reference to a check which the latter's clerk altered after it had been signed, and before it was paid by the bank. The court said that the plaintiffs, who were the depositors, owed to the bank 'the duty of exercising due diligence to give it information that the payment was unauthorized; and this included not only due diligence in giving notice after the forgery, but also due diligence in discovering it.' If the plaintiffs knew of the mistake, or if they had that notice of it which consists in the knowledge of facts which, by the exercise of due care and diligence, will disclose it, they failed in their duty; and adoption of the check and ratification of the payment will be implied. They cannot now require the defendant to correct a mistake to its injury from which it might have protected itself but for the negligence of the plaintiffs. Whether the plaintiffs were required, in the exercise of due diligence, to read the monthly statements or to examine the checks, and how careful an examination they were bound to make, and what inferences are to be drawn, depend upon the nature and course of dealing between the parties, and the particular circumstances under which the statements and checks were delivered to them.' So in Hardy *v.* Chesapeake Bank, 51 Md. 562, 591, which was also a case where checks forged by the confidential clerk of the depositor had been paid by the bank, and, as shown by the pass book, were charged to his account, the court, upon an elaborate review of the authorities, said, upon the general question, that 'there is a duty owing from the customer to the bank to act with that ordinary diligence and care that prudent business men generally bestow on such cases, in the examination and comparison of the debits and credits contained in his bank or pass book, in order to detect any errors or mistakes therein. More than this, under ordinary circumstances, could not be required.'"

CHAPTER XII.

COLLECTIONS.

§ 332. General rules.
333. Duty of bank.
334. Rules as to notes payable at bank.
335. When a bank is liable for failure to collect notes.
336. What action on its part will relieve a collecting bank from liability.
§ 337. Rules as to checks and drafts.
338. Negligence of a bank as to check held for collection.
339. When a bank collecting a draft is liable to the owner.
340. When indorser of check is relieved from liability.

§ 332. General rules.— An indorsement of a promissory note "for collection" makes the indorsee an agent for the collection of the note.[1] Such an indorsement is restrictive and cannot be shown, by parol, to be absolute.[2] A bank, though it may have no interest in it, for certain purposes must be considered the holder of a note left with it for collection.[3] A bank has authority only to receive payment of a note placed with it for collection; it cannot sell or transfer it.[4] A bank receiving notes for collection from its regular correspondent, cannot apply them to balancing the account between them where it knows the notes were sent for

[1] Rock County National Bank *v.* Hollister, 21 Minn. 385.

[2] Third National Bank *v.* Clark, 23 Minn. 263. As to kind of agency a bank has when a note or bill is placed with it for collection, its duty and its liability for negligence in the discharge of that duty, see Bank of Mobile *v.* Huggins, (1841) 3 Ala. 206. In this case the Alabama Supreme Court differs as to the duty to cause the note to be protested with the New York courts in Smedes *v.* Utica Bank, 20 Johns. 372: s. c., on error, 3 Cowen, 663; McKinster *v.* Bank of Utica, 9 Wend. 46; s. c., on error, 11 Wend. 473. They refer to Colt *v.* Noble, 5 Mass. 167; Tunno *v.* Lague, 2 Johns. Cas. 1. The question of damages in such cases is fully discussed by the Alabama courts, and they comment upon Bank of Washington *v.* Triplett & Neale, 1 Pet. 26, and Van Wart *v.* Woolley, 3 B. & C. 439; Hamilton *v.* Cunningham, 2 Brock. 350; Stowe *v.* Bank of Cape Fear, 3 Dev. 408; Branch Bank at Montgomery *v.* Knox, 1 Ala. 148. They differ with the Louisiana Supreme Court in Durnford *v.* Patterson, 7 Mart. 460; Crawford *v.* Louisiana State Bank, 1 Mart. (N. S.) 214; Montillet *v.* Bank of the United States, 1 Mart. (N. S.) 365; Pritchard *v.* Louisiana State Bank, 2 La. 415; Miranda *v.* City Bank, 6 La. 741. They comment on Allen *v.* Suydam, 17 Wend. 368; St. John *v.* O'Connel, 7 Port. (Ala.) 466.

[3] Burnham *v.* Webster, 19 Me. 232.

[4] Wolff *v.* Walter, (1874) 56 Mo. 292; Fuller *v.* Bennett, 55 Mich. 357.

collection and that they belonged to a third person.[1] Paper coming from one bank to another indorsed, and with directions to collect it, and there being nothing to indicate that the paper does not belong to the bank remitting it, may be regarded the paper of the latter, although it may have been deposited by the indorser in the remitting bank for collection.[2] One depositing with a bank for collection negotiable paper payable at a distant point, is chargeable with knowledge of the custom of banks to intrust the paper to other banks for collection at the place where payment is to be made. The bank receiving such paper becomes responsible to the depositor as agent, with authority to employ another bank to collect it, and will not be liable for the negligence of its correspondent in making the collection, if it has used reasonable care in the selection of its correspondent.[3] A bill of exchange or note received by a bank for collection which is payable at a distant place, must be seasonably transmitted by the receiving bank to a suitable bank or other agent at the place of payment.[4] A bank should neither send a check received by it for collection directly to the bank on which it is drawn, nor accept in payment a draft of the latter on another bank. But the collecting bank's negligence would be condoned by an order from the depositor to hold such a draft for a few days.[5] A suitable agent must be some other than the one who is to make the payment.[6] In receiving a note for collection a bank assumes the duty of taking the proper steps to fix the liability of the indorser, and for a neglect of that duty is responsible to the extent of the damages suffered thereby.[7] Commercial paper having been received by a bank for collection, there is an implied undertaking on its part that in case of its dishonor, the bank will take all steps necessary to protect the holders' rights against all previous parties to the paper.[8] A bank

[1] Sweeny *v.* Easter, 1 Wall. 166.

[2] Cody *v.* City National Bank, 55 Mich. 379.

[3] Guelich *v.* National State Bank, 56 Iowa, 434. As to the duty of a bank when a note is placed with it for collection, see Fabens *v.* Mercantile Bank, (1839) 23 Pick. (Mass.) 330; Phipps *v.* Millbury Bank, (1844) 8 Met. (Mass.) 79; Steele *v.* Russell, 5 Neb. 214.

[4] Drovers' National Bank *v.* Anglo-American P. & P. Co., 18 Bradw. (Ill.) 191.

[5] Hazlett *v.* Bank, 132 Pa. St. 118; s. c., 25 W. N. C. 282.

[6] Ibid. Bank *v.* Goodman, 109 Pa. St. 422.

[7] West *v.* St. Paul National Bank, (1893) 54 Minn. 466; s. c., 56 N. W. Rep. 54; Borup *v.* Nininger, 5 Minn. 523; Jagger *v.* National German-American Bank, 53 Minn. 386; s. c., 55 N. W. Rep. 545.

[8] Jagger *v.* National German-American Bank of St. Paul, (1893) 53 Minn. 386; s. c., 55 N. W. Rep. 545.

exercising reasonable care and skill in selecting an agent to present paper received for collection at a distant place will not be liable for that agent's default.[1] The duty of a bank, where it receives a bill or note for collection, and its transmission to another place is necessary, is discharged by sending it in due season to a competent, reliable agent, with proper instructions for its collection.[2] A collecting bank, in another city, cannot, on

[1] Stacy *v.* Dane County Bank, 12 Wis. 629; Lee *v.* Bank, 1 Chest. (Pa.) 109. As to a note payable at another place, left for collection with a bank, and its seasonably transmitting it to a suitable bank in that place for collection, and the transmitter not being liable for any negligence of the latter, see Fabens *v.* Mercantile Bank, (1839) 23 Pick. 330; Dorchester & Milton Bank *v.* New England Bank, (1848) 1 Cush. (Mass.) 177.

[2] Ætna Insurance Co. *v.* Alton City Bank, (1861) 25 Ill. 243. As to the question of liability of a bank, occurring from the acts of its correspondents, the Illinois court said: "Upon examination of the adjudged cases it will be found that entire harmony upon this question does not prevail. In the case of The Mechanics' Bank *v.* Earp, 4 Rawle, 384, it was held that a bank in which bills had been deposited, having only received them for transmission to their agents for collection, at the place of the residence of the drawees, with the instructions of the depositors, was not liable for the failure of the bank to whom the bills were transmitted to collect the money. In that case the court refers to the cases of Lawrence *v.* Stonington Bank, 6 Conn. 528, and The Bank of Washington *v.* Triplett & Neale, 1 Pet. 25, and Jackson *v.* Union Bank, 6 Harr. & J. (Md.) 148, as sustaining the rule announced. Again, in the case of The Bank of New Orleans *v.* Smith, 3 Hill (N. Y.), 560, the court held that when a bill is left with a bank for collection, and they transmit it in due season to a competent agent at the place of the residence of the drawee, with the necessary directions, that they thereby fully discharge their duty and incur no further liability. In support of the rule the court refers to the cases of East-Haddam Bank *v.* Scovil, 12 Conn. 303, and Fabens *v.* The Mercantile Bank, 23 Pick. 330. The court also refer to and approve of the case of Allen *v.* Merchants' Bank of N. Y., 15 Wend. 482, where the same doctrine is announced in these words: 'And we find, on an examination of these cases, they fully sustain the rule announced in this case.' It is true that the case of Allen *v.* The Merchants' Bank, 22 Wend. 215, decided by the Court of Errors, announces a different rule and reverses the decision of the Supreme Court. In that case the decision was by a divided court, the chancellor delivering a dissenting opinion. The last case extends the rule, so that a bank receiving commercial paper for collection is liable for loss resulting from neglect, to banks receiving such paper for transmission, where loss occurs by neglect of the agent to whom it is transmitted, and makes no distinction in the two classes of cases. Where a bank receives a bill or note for collection against a drawee or maker, resident at the place of the bank, or where the bank undertakes for its collection by their own officers, there can be no doubt that it would be liable for any loss that might result from neglect."

failure of its correspondent, the transmitting bank, credit the proceeds of a draft or note, sent to it for collection, to its own account. It is liable to the owner.[1] A bank will not be rendered liable for its omission to have a negotiable note, deposited with it for collection, protested, where a by-law of the bank required the costs of protesting to be deposited with it, which had not been done.[2] If bankers undertaking to collect bills, checks or notes for others neglect to give notice of the default of the makers, where it is the usage of banks to give such notice, they will be liable to the holders in damages.[3] A banker cannot hold the proceeds of a note, sent to him for collection and credit by a correspondent, against the real owner of the note to apply on the credit of collections sent him by this correspondent, because he may keep an account with that correspondent for his convenience, made up of money put there by him to draw exchange against it.[4] Where banks had kept account current with each other for years, crediting the one the other with paper received, etc., and the paper appeared to be the property of the bank remitting it, it has been held that there was a lien for general balance on the paper so transmitted, no matter who was the owner.[5] The bank, to which was originally transmitted, for collection, drafts drawn on a corporation, sending them to a third bank for collection, and the latter taking acceptances from the officer on whom they were drawn, instead of the corporation itself, has been held liable to the bank originally transmitting the drafts for the damage ensuing from the act of the third bank.[6] The accidental loss or disappearance in a bank of a bill sent to it for collection would be presumptive proof of negligence.[7] Where one places in a bank, for collection, notes and drafts on third persons, giving no instructions as to the kind of funds in which it may collect them, should

As to a bank being relieved of responsibility by using due diligence in the selection of the correspondent to which it transmits for collection a bill or note left with it for collection, see Daly *v.* Butchers & Drovers' Bank, (1874) 56 Mo. 94.

[1] Hackett *v.* Reynolds, 114 Pa. St. 328.

[2] Pendleton *v.* Bank of Kentucky, (1824) 1 Mon. (Ky.) 171.

[3] Smedes *v.* Utica Bank, (1823) 20 Johns. 372; Bank of Utica *v.* McKinster, (1833) 11 Wend. 473; Curtis *v.* Leavitt, 15 N. Y. 9, 167.

[4] Bury *v.* Woods, (1885) 17 Mo. App. 245.

[5] Bank of Metropolis *v.* New England Bank, 1 How. 234.

[6] Exchange National Bank *v.* Third National Bank, 112 U. S. 276.

[7] Chicopee Bank *v.* Philadelphia Bank, 8 Wall. 641.

the bank receive payment in a currency then in general use, of a depreciated character as compared with gold, the bank will be held liable only for the real value of such depreciated currency.[1] A bank receiving a check in payment of a note held by it against the drawer, after the check has been paid, cannot refuse to deliver up the note for cancellation on the ground that it had not matured.[2] A collection made by a bank after it has suspended, must be held by it as agent in trust for the owner.[3] The negligence of a collecting bank in not presenting a draft for payment, is the negligence of the holder.[4] A bank's duty, where a note is left with it for protest, is to exercise ordinary and reasonable diligence in giving notice.[5] A known custom to demand payment of a note, left with a bank for collection, without actually presenting the note to the maker in person, would be binding upon indorsers.[6] A known custom of a bank to demand payment on the day before, or the day after, a note falls due, would be binding on an indorser.[7]

§ 333. Duty of bank.— When a bill or note is received by a bank for collection in the ordinary course of business, without any special agreement on the subject, and the bank in due time

[1] Henry *v.* North. Bank of Ala., 63 Ala. 527, in which the collections were made in confederate money.

[2] Union Savings Association *v.* Clayton, (1878) 6 Mo. App. 587.

[3] Jockusch *v.* Towsey, 51 Tex. 129.

[4] Harvey *v.* Bank, 119 Pa. St. 212.

[5] Mount *v.* First National Bank, 37 Iowa, 457. As to liability of a bank, receiving note for collection and failing to notify indorsers of its protest, and thereby discharging them, for the holder's loss, see Bank of Washington *v.* Triplett, 1 Pet. 25; Bird *v.* Louisiana State Bank, 93 U. S. 96. As to the duty of bankers in such cases, see Britton *v.* Niccolls, 104 U. S. 757. As to liability for neglect on the part of a bank receiving a note for collection, see Thompson *v.* Bank, 3 Hill (S. C.), 77. As to a bank's being protected from liability by its usage, and not being liable for the negligence of a notary in the matter of demand and protest, see Warren Bank *v.* Suffolk Bank, (1852) 10 Cush. (Mass.) 582.

[6] Jones *v.* Fales, (1808) 4 Mass. 245; Whitwell *v.* Johnson, (1821) 17 Mass. 452; City Bank *v.* Cutler, (1826) 3 Pick. (Mass.) 414.

[7] Jones *v.* Fales, (1808) 4 Mass. 245; City Bank *v.* Cutter, (1826) 3 Pick. (Mass.) 414. What is a sufficient demand for payment of a note left with a bank for collection, see Tredick *v.* Wendell, 1 N. H. 80. The effect of usage on the part of banks concerning demands on makers of notes, and notices to indorsers, see Lincoln & Kennebeck Bank *v.* Page, (1812) 9 Mass. 155; Smith *v.* Whiting, (1815) 12 Mass. 8; Blanchard *v.* Hilliard, (1814) 11 Mass. 85; Central Bank *v.* Davis, (1837) 19 Pick. (Mass.) 375; Chicopee Bank *v.* Eager, (1845) 9 Met. (Mass.) 583.

delivers it to the notary usually employed by it in such matters so that the necessary demand, protest and notice may be made and given, the bank will not be answerable for loss resulting from the failure of the notary to perform his duty.[1] Personal notice to the indorser may be dispensed with, and he will be charged by the bare deposit of notice in the post office, even if it never comes to hand.[2] In case a note payable on demand, at a particular place, be lost, a court of equity affords no remedy to the owner before a demand for payment has been made at the place designated.[3] A notice to a distant indorser of the protest, etc., of a note payable at bank must ordinarily be sent to his nearest post office, but this rule may be dispensed with if shown that the notice was sent to the place where the indorser would get the earliest intelligence.[4] In case the holder of a note delivers it to a bank with the understanding that this bank shall forward the note to another bank for collection, and it is so forwarded and received, the latter bank will be responsible to the owner of the note for any negligence in its collection whereof the owner of the note may suffer loss.[5] So where the latter bank delivers such note to the notary public for demand, protest and notice, such notary was the attorney of the bank and was incompetent for the purpose of making such demand and serving such notice, and the demand was not properly made and notice was not properly served, so that the indorsers of the note were entirely discharged, the bank was held responsible to the owner of the note.[6] A bank having received a note for collection with direction that it should receive payment of the note in New York exchange, it being a bank of exchange as well as of deposit, the Iowa Supreme Court held the acceptance in payment by the bank of its own certificate

[1] Citizens' Bank of Baltimore *v.* Howell, 8 Md. 530.

[2] Bell *v.* Hagerstown Bank, 7 Gill (Md.), 223.

[3] Streater *v.* Bank of Cape Fear, 2 Jones Eq. (N. C.) 31.

[4] Bank of the United States *v.* Lane, 3 Hawks (N. C.), 453. An illustration of a lack of diligence on the part of a bank in sending notice of dishonor of a protested bill of exchange to the indorser. Runyon *v.* Montfort, Busb. (N. C.) 371. As to liability of banks for neglect in protesting, etc., notes deposited with them for collection, see Chapman *v.* McCrea, (1878) 63 Ind. 360. As to available defense of bank when charged with such neglect, see Locke *v.* Merchants, National Bank, (1879) 66 Ind. 353. Liability of bank for failure to present a bill to the drawee, see Tyson *v.* State Bank, (1842) 6 Blackf. (Ind.) 225.

[5] Bank of Lindsborg *v.* Ober, (1884) 31 Kans. 599.

[6] Ibid.

of deposit payable on demand was a discharge of the indebtedness, notwithstanding its failure to remit the amount to the creditor and afterwards becoming insolvent, it appearing that on the day it received this payment the bank was paying its obligations and had money on hand with which the certificate could have been paid in cash if demanded, although it was actually insolvent, that fact not being known to the holder of the certificate.[1] The measure of damages in an action against a bank with which a bill has been deposited for collection, and it has failed to take proper steps to charge the drawer or indorsers, whereby the holder of the bill was unable to collect it, is the face of the bill, with interest.[2] By delivering a bill held by it for collection to a notary with instructions to protest on the wrong day, a bank would render itself liable to the owner of the bill.[3] It seems though that where negotiable paper is delivered to a bank for collection merely, the bank's duty will be discharged by a proper demand of payment, and by giving notice of its non-payment to the bank's principal only, without giving the proper notice also to other indorsers, unless some contract or commercial usage be shown to raise a more extended obligation.[4] In a Massachusetts case it appeared that a bank, holding a note for collection, received the amount from an agent of the maker, and by mistake gave up to him a similar note of another person and returned the first note to its owner, to whom the maker paid it on demand, and immediately, though four days after the payment to the bank, examined the note in his agent's hands, and, discovering the mistake, returned it to the bank and demanded back his money. The Supreme Court of Judicature held that he was entitled to recover it back, with interest from the time of the demand, although the bank had meanwhile paid the amount to the owner of the other note, the maker of which was insolvent and the

[1] British & American Mortgage Co. *v.* Tibballs, 63 Iowa, 468.

[2] American Express Co. *v.* Haire, (1863) 21 Ind. 4. For an illustration of the owner of a promissory note placed for collection through a bank and its correspondent not sustaining damage, see Indig *v.* National City Bank of Brooklyn, (1880) 80 N. Y. 100.

[3] Commercial Bank of Kentucky *v.* Varnum, (1872) 49 N. Y. 269. As to the liability of a collecting bank taking a draft which may be dishonored, see First National Bank of Meadville *v.* Fourth National Bank, 77 N. Y. 320; s. c., 33 Am. Rep. 618.

[4] State Bank of Troy *v.* Bank of the Capitol, (1863) 17 Abb. Pr. 364; s. c., 41 Barb. 343; 27 How. Pr. 57.

indorsers discharged for want of demand.[1] A contract to be so responsible, expressly proven or inferable from an unequivocal course of dealing, is necessary to hold a banker receiving paper for collection absolutely responsible for the amount previous to collection.[2] A bank will not be discharged from its obligations to procure a proper presentment and notice in case of non-payment of a note deposited with it by one of its customers for collection with a request to have it protested if not paid, by merely employing a notary for the purpose of making a demand.[3] Where presentment is not necessary to charge the parties, and would be useless if made, a bank with which a draft is placed for collection would not be liable for neglect to present it.[4] A maker of a note paying it to the bank holding it for collection cannot recover the payment from the bank on the ground that the bank has failed to remit to the owner.[5] A bank will not be held liable for an omission to protest notes deposited with it for safe-keeping and not for collection.[6] The plaintiff bank in a Connecticut case brought its action to recover of a national bank in the hands of a receiver the amount of notes or bills sent by it for collection to this bank. The circumstances were these: Its cashier had given notice to the cashier of the defendant bank to protest and return all paper not paid. The notes, drafts and checks of one of the makers which had been sent by the plaintiff bank to the cashier of defendant bank for collection and charged

[1] Andrews *v.* Suffolk Bank, (1859) 12 Gray (Mass.), 461.

[2] Scott *v.* Ocean Bank, (1861) 23 N. Y. 289, affirming 5 Bosw. 192.

[3] Ayrault *v.* Pacific Bank, (1868) 6 Robt. (N. Y.) 337; affirmed in 47 N. Y. 570.

[4] Mobley *v.* Clark, (1858) 28 Barb. 390. In Jacobsohn *v.* Belmont, 7 Bosw. 14, a banker, who, under peculiar circumstances, acted with the knowledge and concurrence of the owner of the paper in delaying to present it for collection was held not liable for negligence.

[5] Smith *v.* Essex Co. Bank, (1856) 22 Barb. 627.

[6] New Orleans Canal Co. *v.* Escoffle, 2 La. Ann. 830. As to diligence required of a bank receiving a note or bill for collection, and its liability in default of such diligence, see Capitol State Bank *v.* Lane, 52 Miss. 677. As to the rules governing as to demand and presentment of notes payable at bank, see Lewis *v.* Planters' Bank, 3 How. (Miss.) 267; Ellis *v.* Commercial Bank of Natchez, 7 How. (Miss.) 294; Harrison *v.* Crowder, 6 Smedes & Marsh. (Miss.) 464; Barlow *v.* Planters' Bank, 7 How. (Miss.) 129. When the note remains during the whole day of the day it falls due, allowing days of grace, see Duncan *v.* Watson, 6 Cush. (Miss.) 187; Goodloe *v.* Godly, 13 Smedes & Marsh. (Miss.) 233; Bland *v.* Commercial & Railroad Bank, 3 Smedes & Marsh. (Miss.) 250.

to the latter and posted in the account against the defendant bank, were not paid by him or the acceptors and were protested or returned, and no notice of their non-payment was given to the plaintiff. A semi-monthly statement of the account was sent by the cashier of the remitting bank to the cashier of the collecting bank and its correctness acknowledged by the latter. The Supreme Court held that the remitting bank had a right, after a reasonable time had elapsed without notice of non-payment or a return of the papers, to charge the amount of the notes, bills and checks to the defendant bank and to recover in assumpsit for an account stated.[1] In case the holder of a note delivers it to a bank, with directions as to the appropriation, but not the manner of realizing the proceeds, the bank will be authorized to discount the note or collect it at maturity.[2]

§ 334. Rules as to notes payable at bank.—The presumption is proper that when a note is made payable at a bank the parties expect collections to be made through the bank, and, though the bank holding the money is technically the agent of the depositor, yet the money that may be deposited to meet such a note is deposited for the holder of the note, and it would require no act of the depositor to authorize the bank to pay it.[3] Where a note was made payable at a bank and the maker deposited with the bank the amount necessary to fully discharge it, and the bank afterwards failed, the Iowa Supreme Court held

[1] National Pahquioque Bank *v.* First National Bank of Bethel, (1870) 36 Conn. 325. In this case the bank defended partly on the ground of fraudulent practices of its cashier in collusion with the drawee. Of this branch of the defense, the court said: "It is perfectly apparent that the cashier of the defendant bank received the notes, drafts and checks sent by the plaintiffs for collection; that he had ostensibly the powers usually given to the cashier of such an association; that it was his duty to collect them or to protest and return them; and that by retaining them without collection, protest or notice, he made the defendant bank liable to the plaintiffs for their amount. The finding shows gross fraud on his part, by concluding with Seeley, to permit his paper to accumulate in the bank unpaid, by failing to enter the paper upon the books of the bank, and to inform the directors of its possession and non-payment, and in permitting the account of the plaintiff to accumulate in such an unusual manner and to such an unusual extent without informing them of it. It also shows gross negligence in the officers of the defendant bank in intrusting its entire management to [the cashier]. But these facts do not constitute a defense, unless knowledge of them can be brought home to the plaintiff."

[2] Drown *v.* Pawtucket Bank, (1833) 15 Pick. (Mass.) 88.

[3] Lazier *v.* Horan, 55 Iowa, 75.

that the deposit was a full defense to the action of the payee or indorsee against the maker.[1] Notes payable at bank must be presented to the bank for payment to charge the indorser.[2] A bank would not be authorized to receive the money for the payee of a note not in its possession simply because the note was made payable at that bank.[3] When a note payable at a bank is held by it, the note should remain in the bank until the completion of business hours.[4] The known custom of a bank, that notice to the directors thereof, who are indorsers on notes, should be left on the cashier's desk, instead of being delivered to the directors, would be binding on the directors.[5] The practice of banks to give notice to the makers of notes of the time of their maturity cannot, where such notice has been delivered, be substituted for a demand for payment so as to charge the indorser.[6] A bank which by mistake has certified a promissory note made payable at its banking house to be "good" can correct such mistake before rights and liabilities have been incurred or losses sustained in consequence of it.[7] When a note is made payable at a bank, all that the holder is required to do is to make demand for payment at the bank.[8] Where a note payable at bank is left there, and remains during banking hours on the last day of grace, and no funds are provided for taking it up, that would be sufficient evidence of demand and refusal of payment.[9] In the absence of

[1] Ibid.

[2] Sullivan *v.* Mitchell, 1 Carolina Law Repository (N. C.), 482; Smith *v.* McLean, N. C. Term Rep. 72.

[3] Cheney *v.* Libby, 134 U. S. 68.

[4] Planters' Bank *v.* Markham, 5 How. (Miss.) 397. In Dewey *v.* Bowers, 4 Ired. (N. C.) 538, a bank received from the maker of a note which it had discounted a draft on New York and agreed to apply the proceeds, if the draft was collected, to the payment of the note after declining to receive the draft in discharge of the note. Afterwards the cashier of the bank, by mistake, supposing the draft to have been paid, canceled the note and delivered it to the principal. It was soon ascertained that the draft had been protested and never paid. It was held that the bank, under the circumstances, was entitled to recover from the principal and his trustees the amount of the note so canceled and delivered up.

[5] Weld *v.* Gorham, (1813) 10 Mass. 366. As to notice of protest by mail where that method of service is the usage, see Benedict *v.* Rose, 16 S. C. 629. As to notice by a bank of non-payment of note, see Bank *v.* Wallace, 13 S. C. 347.

[6] Farmers' Bank of Maryland *v.* Duvall, 7 G. & J. (Md.) 78.

[7] Second National Bank of Baltimore *v.* Western National Bank of Baltimore, (1878) 51 Md. 128.

[8] Bank *v.* Flagg, 1 Hill (S. C.), 177.

[9] Lafayette Bank *v.* McLaughlin, (Super. Ct. Cincinnati, 1846) 4 West. Law J. 70.

any special contract, a bank with which notes are deposited is only bound to receive the money, if paid, and, if not paid, to fix the liability of the parties by due demand and notice.[1] The maker of a note payable at bank will be presumed to consent to be governed by the custom of the bank with regard to making them and of payment of such notes.[2] Where, by the custom of a bank, notes payable there and in its possession and not paid during banking hours on the day on which they fall due, are considered as dishonored, without any formal demand, then no such formal demand and presentment would be necessary to charge an indorser.[3] Where the bank at which a note is payable is the holder, it would be a sufficient demand for the officers of the bank to hand it to a notary after banking hours, telling him there are no funds to meet it.[4] When discounting a note or bill, should a bank inquire of the one presenting it as to the indorser's residence, and send a notice to the place named, this would be sufficient to charge the indorser, even though he may never have resided at the place named.[5] A person indorsing a note with the knowledge of a custom of a bank not to give out notes for protest until three o'clock on the third day of grace would be bound thereby.[6] Where the known and established usage in a bank as to papers, the third day of grace on which falls on Sunday, is not to demand payment until Monday, the bank receiving a note, the third day of grace falling on Sunday, to be collected according to the known and established mode of transacting its business,

[1] Crow *v.* Mechanics' Bank, 12 La. Ann. 692.

[2] Harrison *v.* Crowder, 6 Smedes & Marsh. (Miss.) 464.

[3] Cohea *v.* Hunt, 2 Smedes & Marsh. (Miss.) 227. In Mount *v.* First National Bank, 37 Iowa, 457, the note was left with the bank for protest without direction as to where notice to the indorser was to be sent. The notice was sent by mistake to a person of the same name as that of the indorser and living in the neighborhood. The court held that the bank was not liable for negligence.

[4] U. S. Bank *v.* Carneal, 2 Pet. 543.

[5] Palmer *v.* Whitney, (1863) 21 Ind. 58. In Commercial & Railroad Bank *v.* Hamer, 7 How. (Miss.) 448, it was held that generally a note payable in bank should be presented for payment during banking hours, but where it was the custom of the bank to keep its back door open, with its teller present after banking hours to answer demands then made, and a note was then presented, and the teller answered, according to the truth of the case, that there were then no funds and had not been during the day to pay the note, the presentment was good.

[6] Bank of Columbia *v.* Mc Kenny, 3 Cranch Cir. Ct. 361.

would not be liable to damage for omitting to demand payment on Saturday.[1]

§ 335. When a bank is liable for failure to collect a note. — An Ohio bank having purchased a note payable at the banking office of another bank, from the payee, the payee indorsing the same, sent it to the bank, at which the note was payable, for collection. The note was not paid when it matured, and the bank owning the note brought its action against the bank, its agent, for collection, upon the ground that by its negligence the owner had lost its right to hold the indorser liable. The trial court rendered a judgment in favor of the defendant. This judgment was reversed by the Supreme Court of Ohio, which held that the bank which held the note for collection had been guilty of negligence in the matter and was thereby liable to the owner of the note.[2]

[1] Patriotic Bank *v.* Farmers' Bank of Alexandria, 2 Cranch Cir. Ct. 560. As to liability of bank for negligence in such matters, see Bank *v.* Burns, 12 Colo. 539; s. c., 21 Pac. Rep. 714; Drovers' Nat. Bank *v.* Anglo-American Packing & Prov. Co., 117 Ill. 100; s. c., 7 N. E. Rep. 601; Bank *v.* Goodman, 109 Pa. St. 424; s. c., 2 Atl. Rep. 687; Farwell *v.* Curtis, 7 Biss. 162; Indig *v.* Bank, 80 N. Y. 100; Briggs *v.* Bank, 89 N. Y. 182. In Holmes *v.* Roe, 62 Mich. 199, it was held that where the person receiving a check upon a banker and the banker on whom it is drawn are in the same place, in the absence of special circumstances it must be presented for payment the same day or, at least, the day after it is received; but, if in different places, the check must be forwarded for presentment on the day after it is received at the latest. See, also, Hamilton *v.* Winona Salt & Lumber Co., (1893) 95 Mich. 436.

[2] Bank *v.* Bank, (1892) 49 Ohio St. 351. The opinion of the court evinces a full and careful discussion of the law relating to the questions involved, and shows such a statement of the facts which explain its ruling, that we give it in the words of the court. It was said: "The real contention between the parties was whether [the payee], the indorser of the promissory note, had been discharged from liability to the [plaintiff] by reason of the negligence of the [defendant]. The note had been transmitted to the [defendant] for collection and was not paid at maturity. If [defendant] by its negligence had discharged the indorser, then it should be held liable for the damage it thereby caused; but if, notwithstanding the alleged negligence, [the indorser] remained liable, it should be exonerated, for all the duty it owed to the [plaintiff], in case the note was not paid, was to take such action as would charge the indorser. When the note matured the [defendant] in error notified the makers and one of them came to its banking house. A plain and simple duty then confronted the [defendant]: Either to require payment of the note, or, in default thereof, to take such action as by the law merchant was necessary to charge the indorser. It did neither. That the note was conditionally paid is suggested; what that may mean in this connection is not clear. No doubt, that, as between the holder and the maker of a promissory note, a conditional payment may be made; but the rules of the commercial law require a holder, who intends to hold an indorser liable, to give notice to the latter of the default of the maker. Anything less than a full and absolute payment is a default, but nothing less than that measures the duty of the maker. In this case, however, there was no conditional payment made. True, the [defendant] had in its hands the means of enforcing payment, but did nothing; it simply accepted the maker's promise that, if [the payee] did not give further time, they would pay the note. If the [defendant] had given notice to the [plaintiff] of the default of the maker, it would have discharged its duty, for it would have afforded the latter an opportunity to give notice to [the indorser]. Lawson *v.* Bank, 1 Ohio St. 206. Where, however, a holder of a promissory note passes by an immediate indorser, and serves notice of non-payment upon one more remote, he cannot avail himself of the time the immediate indorser would have had to serve the remote one if the holder had given notice to the former; but the holder in that case must give notice to the remote indorser within the same time that he is required to give it to the immediate indorser. 1 Parsons on Notes & Bills, 514; Dobree *v.* Eastwood, 3 Car. & P. 250; Simpson *v.* Turney, 5 Hump. 419; Rowe *v.* Tipper, 13 C. B. 249; Marsh *v.* Maxwell, 2 Camp. 210. Therefore, if the letter of [the makers] had been sufficient in form and substance to fix the liability of [the payee indorser] it was mailed too late and for that reason he was discharged. This release of [the indorser] was an accomplished fact before the makers of the note applied to him to extend the time of payment. The omission of the bank to require payment, or in default thereof to give the necessary notice to charge [the indorser] was caused by the solicitation of the makers. * * * The most careful scrutiny of the record fails to disclose that [the indorser], up to this time, said or did anything to mislead the bank or to induce it to relax its vigilance, or omit any step necessary in law to charge him as indorser. [The indorser], therefore, had a perfect defense against any action taken to charge him as an indorser, unless by his subsequent conduct he has forfeited his right to set up this defense." After discussing whether there was sufficient notice to the indorser and whether he was estopped to defend, the court then made this query: "Was due diligence shown in giving this notice?" This was answered as follows: "The last day of grace was October 17 and the letter was not mailed until the 19th, two

§ 336. What action on its part will relieve a collecting bank from liability. — The United States Circuit Court of Appeals for the sixth circuit has held that a bank receiving a certificate of deposit issued by a bank for collection and mailing it to the bank which issued it, with a request for a remittance, was guilty of negligence. But in this particular case it appeared that the plaintiff bank on May 8, 1888, mailed to the defendant bank the certificate of deposit for collection, and on May ninth the lat-

ter mailed it to the bank issuing it. On June first the defendant bank credited the plaintiff bank with the item in the account current for May, and wrote that nothing had been heard from the bank issuing the certificate after repeated inquiries, and requested that the matter be investigated and a duplicate or a

days later. To constitute due diligence it should have been deposited in the post office in time to have departed in the earliest mail to the residence of [the indorser] that departed after business hours on the 18th. Lawson *v.* Bank, 1 Ohio St. 206. It is true that if the [defendant] had chosen to give notice of non-payment to the [plaintiff] that the [plaintiff] would have had one day after it received notice within which to give notice to [the indorser] and in that case a notice to [by?] the [plaintiff] to [the indorser] on the 19th of October would have been in time. 1 Pars. on Notes & Bills, 513; Lawson *v.* Bank, 1 Ohio St. 206. On October 17, 1888, the day after the note matured, one of the makers * * * was called into this bank and his attention was directed to it; the makers then had funds in the bank which could have been applied to its payment, but upon [this maker's] representation that his firm was pressed for means it was induced to indulge them until they could apply to [the payee] for a short extension of the time of payment, promising to pay it if [he] refused to extend the time. After two days' delay, they mailed the letter of October 19, to which he received in answer [the payee's] letter of the 20th, granting the favor, of which the bank was at once advised; it thereupon continued to receive and pay out for the makers large sums of money until November 1, 1888, on which day the makers assigned their property in trust for their creditors, having assets sufficient to pay only a few cents on the dollar of their indebtedness. No doubt but for this letter of [the payee's] the bank would have charged this note against the maker's deposits, and in that way demand its payment. If [the indorser] had been influenced by the facts, and chose to grant an extension to the makers, and the bank relying thereon had paid out all the funds of the makers before the assignment was made, and thus lost its means of indemnity, he should be held to abide the consequences. But he had no such knowledge. He neither knew that he had been discharged by the bank's neglect, nor that the bank had indemnity within its control. His granting the extension was an indiscreet act in itself, and he should not be charged with consequences that he had no reason to suspect would flow from it. On the contrary, this bank [the defendant here] was an actor in the entire transaction. With means of payment in its hands, it chose to indulge the makers in direct violation of its duty to the [plaintiff]. It knew this indulgence was granted to the makers of the note, expressly, to enable them to apply for an extension of payment to one who, upon the face of the paper, was only liable in case it did the very duty that it must of necessity violate to grant the indulgence. And when the letter from [the indorser] was made known to it, and it proceeded to act upon the extensions granted, it had no reason to believe that he had granted the extension with knowledge of the facts, and it took no action to advise him of their existence. Under these circumstances [the defendant] must be held to have assumed the risks that naturally flowed from its actions, one of which was that [the indorser] might avail himself of a defense thus afforded to him by its own negligence."

remittance obtained from the issues of the certificate. On June twenty-second, having received no answer to this letter, the defendant bank wrote the plaintiff bank that repeated letters about the item had remained unanswered, that they had written the plaintiff bank for a duplicate, and that they now charged the plaintiff bank with the item, which was accordingly done in the account current for June. This closed the correspondence with reference to the matter. The issuers of this certificate continued in good credit until after January 1, 1889, when they failed. The Court of Appeals held that under these facts the defendant bank was not responsible to the plaintiff bank for more than nominal damages, approving of the instruction of the lower court that those letters and the charging back amounted to a renunciation of the defendant's agency so far as the defendant could renounce it, adding that the defendant could not, by its renunciation, put an end to the agency as the facts then were, and relieve itself from liability without the consent, express or implied, of the plaintiff, and that such consent would be implied from the silence of the plaintiff after being informed of the renunciation; and that if the plaintiff made no objection to the renunciation, the defendant was not liable for damage thereafter resulting from events subsequent, and not from the sending of the certificate to the issuers for collection.[1]

§ 337. Rules as to checks and drafts.— A bank receiving a bill for collection from another bank, becomes the agent of the remitting bank and not of the owner of the bill, and, in the absence of agreement to the contrary, would be answerable to the remitting bank for neglect in the discharge of its duties as agent, whereby that bank sustains loss or damage.[2] It is the duty of a bank receiving for collection a bill payable at a future time to use due diligence in presenting it and in giving notice of a failure of due acceptance, or where a bank receives a bill for collection, presents it for acceptance, and gives no notice of non-acceptance, it

[1] First Nat. Bank of Evansville *v.* Fourth Nat. Bank of Louisville, (1893) 56 Fed. Rep. 967.

[2] Commercial Bank *v.* Union Bank, (1854) 11 N. Y. 203.

will be held liable to the owner for the amount of the bill in case the acceptance be defective.[1] A bank acting merely as collecting agent of drafts, without knowledge that the money collected was to be received in any way for its own benefit, or to be applied on an indebtedness to it, or on its own account, will not be held to have received the money in payment of its indebtedness or on its account.[2] A bank receiving a draft for collection, with instructions from the holder of the draft to collect the money due on it and hold the same until called for, by crediting it to the account of another in violation of the instructions, will become liable to the holder for whom collection was made.[3] Where a collection of a draft is made for the owner under a direction of himself, or some one accompanying him, given in his presence and hearing, to hold the money until one or the other of the two should give further directions as to the disposition of the money, and this other person afterwards have the money paid to himself or placed to his credit to make good an overdraft on his own account, the bank would not be liable to the owner for the sum collected.[4] It is the duty of the bank with which a check or bill is deposited for collection, to transmit it to a suitable agent to demand payment in such a manner that no loss may happen to any party to the check, whether the drawer, indorser or indorsee.[5] The acceptor of a bill of exchange, discounted by a bank, with bill of lading attached, which the acceptor or other bank regarded as genuine at time of acceptance, but which proved to be a forgery, has been held bound to pay the bill to the bank at maturity.[6] The rule upon which this holding was made was that bad faith in taking negotiable paper, which will defeat recovery thereon, must be something more than failure to inquire into their consideration, because of rumors or general reputation as to bad character of maker or drawer.[7] The words "for collection," appended to

[1] Walker *v.* Bank of State of New York, (1854) 9 N. Y. 582, affirming 13 Barb. 636.

[2] Merchants' Bank of Canada *v.* Union R. R. & Transportation Co., (1877) 69 N. Y. 373.

[3] International Bank *v.* Ferris, 118 Ill. 465.

[4] Ibid.

[5] Drovers' National Bank *v.* Provision Co., 117 Ill. 100.

[6] Goetz *v.* Bank of Kansas City, 119 U. S. 551.

[7] Ibid. When the holders of drafts must bear the loss where they have not been returned or presented in a reasonable time and the drawer has become insolvent. Collingwood *v.* Merchants' Bank, 15 Neb. 121.

an indorsement upon a check, limit the effect which the indorsement would have without them and give authority to the holder only to collect for the benefit of the indorser.[1] It may be shown by a bank taking a certified check on another bank, either as a payment, on account, or for the purpose only of collection, that the check had availed nothing, where the bank so receiving the check may have discharged its duty by an effort to collect it.[2] A bank receiving a check for collection and retaining it for four days without presenting it for payment, or making any offer for its collection, or giving any notice to the depositor of its non-payment, has been held in North Carolina liable for loss ensuing therefrom.[3] Where a bank received a check upon itself for collection, being at the time a large creditor of the drawer, and failed without excuse to notify the depositor of the non-payment of the check, it was held guilty, in law, of negligence, and that by its action the bank had made the check its own and was liable for its whole amount.[4] A bank receiving a check for collection payable at a day subsequent, would be liable to the owner for failing to present it at the proper time where it had presented it for payment without allowing days of grace.[5] A bank receiving

[1] Hoffman *v.* First National Bank of Jersey City, 17 Vroom (N. J.), 604.

[2] Drovers' National Bank *v.* Provision Co., 117 Ill. 100. In Bickford *v.* First National Bank of Chicago, (1866) 42 Ill. 238, the check was drawn and certified and deposited in a bank after ten o'clock A. M., and before three o'clock P. M. on a certain day, where it remained until next morning, when it was taken in the usual course of business to the bank on which it was drawn. The bank was closed and continued so. The check was protested for non-payment and due notice given. The Supreme Court of Illinois held that there was sufficient diligence to hold the owner of the check. In New York, etc., R. R. Co. *v.* Smith, 4 N. J. Law J. 34, a certified check was given on a New York bank to the agent of the railroad company in Newark. By a rule of the company the agent could not indorse the check, but was required to send it to the principal office in New York city. Two days after the check was given it was returned in due course of collection to the Newark bank, which had meanwhile failed. It was held that there was no negligence in the presentation of this check which would prevent the company recovering the amount of the check from the drawer.

[3] Bank of New Hanover *v.* Kenan, 76 N. C. 340.

[4] Ibid. An illustration of no want want of reasonable diligence in the presentation of a check for payment. Werk *v.* Mad River Valley Bank, (1858) 8 Ohio St. 301. As to the effect of delay in presenting check for payment, see Stewart *v.* Smith, (1867) 17 Ohio St. 82; McGregor *v.* Loomis, (1850) 1 Disney (Ohio), 247.

[5] Ivory *v.* Bank of Missouri, (1865), 36 Mo. 475.

from a depositor a check upon another bank for collection, should the collection fail, without fault of the bank receiving the check for collection, has a right to return the check and cancel the credit given the depositor for the amount.[1] The bank in an Indiana case, holding a check drawn in its favor, indorsed it to a bank "for collection for account of" itself, and sent it by mail to this bank with a letter from its cashier, stating, "I inclose for collection and cr., as stated below" (specifying this and other checks and drafts sent). The check was placed by this bank on its collection register, where were entered only such checks received for collection as were treated as the property of the parties sending them, no credit being given therefor until they were collected. The cashier of this bank indorsed the check for collection and transmitted it to a third bank, with authority by letter to credit the second bank with the proceeds when collected. On the same day the transmitting bank failed and went into the hands of a bank examiner. Two days afterwards the third bank collected the check, with notice by newspaper report of the failure of the second bank, but not notifying the drawee of this fact of which they had no notice. The collecting bank then credited the failed bank with the amount collected on the check, it being then, on account of previous dealings, legally indebted to it. The bank examiner also having in charge the books of the failed bank, without the consent of the remitting bank, credited it and charged the collecting bank with the amount of the check on the books of the failed bank, which, at the time it received the check, was largely indebted to the remitting bank. In this action, brought by the latter against the collecting bank, the court held that it was entitled to recover; that the indorsement of the check to the failed bank did not vest title in it, or give it any right to the proceeds; that the accompanying letter meant that it should collect for the remitting bank and place the proceeds to its credit and not that the failed bank should treat the check as its own or credit the remitting bank therewith before collection; that the transaction did not make the former the debtor of the latter before the check was collected. or deprive the latter of its rights to the check or its proceeds before its collection by the former;

[1] Decatur National Bank *v.* Murphy, (1881) 9 Bradw. (Ill.) 112. See, also, National Gold Bank *v.* McDonald, 51 Cal. 64; Boyd *v.* Emerson, 29 E. C. L. 68.

that the collecting bank was the agent of the failed bank, and being notified by the indorsement on the check that the latter was not the owner of it or entitled to its proceeds, the former had no right to credit the amount to the latter on its indebtedness to the former; that the notice it had of the failure of its correspondent was sufficient to require the collecting bank to regulate its action with a view to the rights of the remitting bank, as affected by the failure of its correspondent; that the directions in the letter of the cashier of the remitting bank to the failed bank constituted an authority to mingle the fund with the general funds of the bank when collected, whereby the former bank would become a general creditor of the latter instead of being entitled to the fund; that the insolvency and suspension of the latter operated as a revocation of such authority, and if it had authority to collect at all after its suspension, the former bank would be entitled to the specific fund, and the collecting bank, being an agent of the failed bank, had no more power or right as to the specific fund than its principal; that the rights of the remitting bank were not injuriously affected by anything done by the bank examiner with its knowledge or consent, and that the fact that the collecting bank had credited the amount collected upon its debt against the failed bank, did not discharge it from liability.[1] A bank to which an inland bill of exchange is transmitted for collection through the intervention of another bank, becomes the agent of the payee and is answerable to him alone for any breach of its duty in relation to the bill.[2] Where accounts are kept between different banks, and one of them fails to pay over money received on drafts or bills of exchange collected for the other, the remedy is against the defaulting bank, and not against the drawer of the bill or draft.[3] Should a bank receive a bill for collection and omit to present it at the proper time or place for payment, and a loss be sustained in consequence of such an omission to present it for payment, the bank would be liable to the extent of the loss.[4] And the right of action against the bank would not be waived by the owner of the bill withdrawing it from the custody of the bank; nor would

[1] First National Bank *v.* First National Bank, (1881) 76 Ind. 561.

[2] Farmers' Bank *v.* Owen, 5 Cranch Cir. Ct. 504.

[3] Kupfer *v.* Bank of Galena, (1864) 34 Ill. 328.

[4] Branch Bank at Montgomery *v.* Knox, (1840) 1 Ala. 148.

the bank be discharged from its liability to answer for its negligence by the pursuit of any of the parties liable upon the bill.[1] The facts of a case in the federal court for the district of Colorado were as follows: The bank sued here received from the plaintiff bank a sight draft for collection, drawn by the plaintiff bank on a third bank against funds actually to the credit of the drawer; the defendant received this draft for collection January tenth, and transmitted it directly to the drawee, its correspondent, on the same day; it should have reached the drawee in two days; the drawee continued good until January twenty-ninth, when it failed. The drawee did not acknowledge the receipt of the draft, and, in fact, the draft miscarried and never reached the drawee; the defendant made no inquiries about it until February ninth; the plaintiff and defendant both supposed, meanwhile, that the draft had been paid; the defendant gave the plaintiff no notice of any kind in respect of the draft until February eleventh. In its action against the collecting bank to recover the amount of the draft, the collecting bank was held liable on the ground that, by its negligent omission of duty, a loss had resulted to the plaintiff.[2] The measure of damages in such a case was held to be the

[1] Ibid. As to the time within which the holder of a bill of exchange must present it for acceptance, see Bank of Bennington *v.* Raymond, 12 Vt. 401.

[2] First National Bank of Trinidad *v.* First National Bank of Denver, (1878) 4 Dill. 290. DILLON, C. J., said: "I have fully examined the adjudged cases relating to the duty and responsibility of a bank which undertakes to act as a collecting agent for its customers or for other banks. They clearly show that the defendant bank ought to have ascertained, within a reasonable time, whether the draft transmitted had been received by its correspondent, and if not to have advised the plaintiff thereof. The practice of banks to send such checks or drafts *directly to the drawee* (as in this case) is attended with some obvious additional peril, and does not weaken, if indeed it does not increase, the diligence required of the collecting bank in respect to inquiry and notice. The defendant bank allowed an unreasonable time to elapse before it made inquiry concerning the draft, and more than a reasonable time had elapsed before the failure of the Kansas City Bank occurred. It was this negligence that caused the loss, since it is established by the evidence that the draft would have been paid if it had been presented at any time before the suspension of the drawee on the 29th day of January. Here, then, was an unexcused delay for fifteen or sixteen days to make any inquiry or give any notice. Aside from the custom or usage pleaded in defense * * * the decisions in England and in this country are uniform that such delay to make inquiry and omission to notify the party interested, as occurred in this case, impose a liability if loss is thereby occasioned."

full amount of the draft.[1] In an early Connecticut case it appeared that the plaintiff had drawn a bill of exchange, payable to his order, upon a person residing in the city where the defendant bank did business; that he indorsed it in blank and lodged it with a New York bank for collection; that the cashier of that bank indorsed it in blank and forwarded it to a bank in Connecticut, the cashier of which indorsed it in the same manner and transmitted it to defendant bank, each of these indorsements being made for the purpose of collection only. The money was paid to the defendant bank by the acceptor, and the defendant claimed in this action of the drawer the right of treating it as a collection on account of the Connecticut bank, through which it came to defendant, and to set off the avails of the collection to the credit of that bank upon the general account between the banks. The Supreme Court of Connecticut held that the defendant was not the factor or banker of the Connecticut bank through which it received the bill, and as agent, or in any other capacity, did not have a lien on the avails of the bill for the general balance of its account with that bank.[2] They further held that the custom of transmitting bills for collection from one bank to another, and crediting on account the avails received, whatever effect it might have had between themselves, could not affect the claims of a third person, who may have confided the collection of a bill to one of them, without assent, either express or implied, to the mode of transacting their business.[3] Where a draft was deposited

[1] First National Bank of Trinidad *v.* First National Bank of Denver, (1878) 4 Dill. 290.

[2] Lawrence *v.* Stonington Bank (1827) 6 Conn. 520. The court referred as follows to certain English cases: "In Jourdaine *v.* Leprone, 1 Esp. 66, it was said by Lord KENYON that a banker had a lien on a note paid into his house, and of course a right to retain it for his general balance. The doctrine more clearly appears from the case of Davis *v.* Bowsher, 5 Term Rep. 488. A customer lodges bills of exchange in the hands of his banker generally, and when the banker advances money to him he applies it to the discount of such of the bills as happen to be nearest in value to the sum advanced, but without any special agreement to that effect. This does not invalidate the banker's general lien upon all the other bills in his hands, but he may retain them in order to secure the payment of his general balance. These cases, and others to the same effect, are inappropriate to the one before us. The transaction of sending notes for collection from one bank to another has no analogy to the payment of notes to a banker and obtaining discount on a part of them."

[3] Lawrence *v.* Stonington Bank, (1827) 6 Conn. 521. That bills of exchange must be presented to the drawees in a reasonable time, and that

in a bank without directions that it should be treated as a separate fund, and was forwarded for collection to another bank, which failed, and the drafts and deposits between the two banks had been constantly changing, it has been held that the owner of the draft should share *pro rata* with other creditors.[1] Where shown in an action against a bank for money received to its credit that the bank was employed to collect certain drafts, and that the money was paid to its correspondent, a bank in the place where the drawee lived, and that the correspondent forwarded a draft for the money to the defendant, it would devolve upon the latter to show that, through no default or want of diligence on its part, the draft was not paid.[2] Where acceptance of a draft is refused, it is not necessary to present the draft for payment.[3] A bank receiving a bill for collection becomes the agent of the owner, and in the discharge of its obligations as his agent is bound to present it for acceptance without reasonable delay, and to present it for payment upon maturity; if not accepted or not paid when presented the bank should take such steps by protest and notice as are necessary to charge the drawer and indorser. Otherwise,

what is a reasonable time depends upon the facts in each case, see Montelius *v.* Charles, 76 Ill. 303; Walsh *v.* Dart, 23 Wis. 334; Knott *v.* Venable, 42 Ala. 186; Veazie Bank *v.* Winn, 40 Me. 60; East River Bank *v.* Gedney, 4 E. D. Smith, 582; Phœnix Ins. Co. *v.* Allen, 11 Mich. 501; Fugitt *v.* Nixon, 44 Mo. 295; Aymar *v.* Beers, 7 Cow. 705; Sice *v.* Cunningham, 1 Cow. 397; Robinson *v.* Ames, 20 Johns. 146; Bachellor *v.* Priest, 12 Pick. 399; Wallace *v.* Agry, 4 Mason, 336.

[1] Edson *v.* Angell, 58 Mich. 336.

[2] Simpson *v.* Waldby, 63 Mich. 439. As to the responsibility of a bank employed to collect drafts upon parties at a distance for the failure or dishonesty of its correspondent selected by itself, see Simpson *v.* Waldby, 63 Mich. 439. As to the right of the owner of a bill remitted through a bank for collection to recover it of the bank, notwithstanding the latter's placing the amount to the credit of its correspondent in settling the latter's indebtedness to it, see Millikin *v.* Shapleigh, (1865) 36 Mo. 596.

[3] Exeter Bank *v.* Gordon, 8 N. H. 66, 78. In Nunnemaker *v.* Lanier, (1867) 48 Barb. 234, the bankers had received for collection a draft upon a trust company, and on presenting the same at their office received in payment the check of the trust company upon a bank and surrendered the draft. The bankers neglected to present the check for payment on the day they received it, and before banking hours on the next business day the trust company suspended payment and its check was dishonored on presentation. The Supreme Court of New York held that the bankers, by surrendering the draft, assumed the responsibility of taking the check of the trust company in payment, and that the existence of a custom in the city of New York among business men to take the checks of the trust company without certification, in the same manner as bank checks, was no defense to an action by the owners of the draft to recover the amount of the same.

it becomes liable to the owner for the damages which he may sustain by such neglect to perform its duties, unless there be some agreement to the contrary, express or implied.[1]

§ 338. Negligence of a bank as to check held for collection. — In a late Kansas case the payee of a check upon a bank brought action against the drawer, basing his action upon the fact that there was money to the credit of the drawer in the bank, and the bank becoming insolvent, had made an assignment, and the check came back unpaid. It appeared that the payee of the check had placed it in the hands of his bank as his agent for collection, and the latter had sent it to the drawee for collection. The question for decision by the Supreme Court of Kansas was stated to be whether the negligence of the payee and his agent, his bank, in sending the check directly to the drawee operated, under the facts agreed upon, to discharge the drawer from liability. The court said: "From the agreed statement it appears that the check reached Richfield on the 12th of December, 1889, after business hours; that the bank on which it was drawn was open, doing a general business, receiving deposits and paying money on checks during its regular banking hours on the thirteenth. During that day a letter was written, addressed to the [payee's bank], with which was inclosed the check and the statement 'No funds in bank.' This letter was deposited in the post office after banking hours, and received at [the place where the check was drawn] after business hours on the fourteenth. The refusal to pay was, therefore, not communicated to any one until the fourteenth. Can it be presumed that if the check had been regularly presented over the counter to the Richfield Bank on the thirteenth a false answer would have been given, as was in fact given by letter and payment refused? It is admitted that the defendant had more than money enough to his credit to meet the check. Had presentment been made by another agent of the plaintiff and payment refused, steps might have been taken immediately to protect the drawer's rights; but, the check being in the hands of the drawee, of course no effort could be made by it to prosecute itself, and the fact that payment was refused was not communi-

[1] Montgomery County Bank *v.* Albany City Bank, (1852) 7 N. Y. 459.

cated to the [payee's bank] until the night of the day following the last one on which the Richfield Bank was open for business. It might be that the answer 'No funds in bank' was literally true, and that the Richfield Bank had not the money with which to make payment at any time during the day of the thirteenth; but we are not at liberty to indulge in any presumptions of that kind, the agreed facts showing that it received deposits and paid checks during the whole of that business day. This case must be decided in accordance with established principles, and the fact that the Richfield Bank was a small concern in a very sparsely peopled part of the state, and perhaps never had any large amount of funds in its possession, cannot be made a pretext for breaking down those wholesome rules of business which have been built up and defined with so much care and precision. The request in this case by letter was not an ordinary demand of payment calling for current funds, but was a request for Kansas City exchange, which the drawee would of course be at perfect liberty to refuse. In cases of this kind a hardship necessarily results to one party or another. Courts, in their decisions, must be guided by fixed rules. The plaintiff, having trusted in the good faith of the Richfield Bank by sending the check to it, must bear the burden of the loss occasioned by its failure occurring after the day on which regular presentment should have been made."[1] It would not be negligence on the part of a bank receiving a check from one of its customers for collection to forward the check by mail; but if, failing to hear from it within a reasonable time, the bank neglects to make inquiry or give notice, this would be negligence, and the bank would make itself liable for ensuing loss occasioned by the drawer's insolvency.[1]

[1] Anderson *v.* Rodgers, (Kans. 1894) 36 Pac. Rep. 1067, 1069. The ruling was the result of an application of the principles declared in these words: "It is true, as was said by this court in Gregg *v.* George, 16 Kans. 546, that 'in order to charge the drawee of a check, the same strict rule of diligence in making demand and giving notice of non-payment does not obtain as in cases of ordinary bills of exchange. As a general rule he is not discharged unless he suffers some loss in consequence of the delay of the holder.' If the drawee of a check has no funds on deposit to meet it, or if, having funds in the bank at the time, he afterwards withdraws them, and the check is not paid on that account, the drawee [drawer?], having suffered no injury by reason of delay in its presentment, will not be discharged from liability; but when a person, having funds on deposit in a bank, draws a check against them, the holder of the check, if he delays its presentment, assumes the risk of the failure of the bank. It is said in Daniels on Negotiable Instruments, (§ 586): 'The fact that the check is presumed to be drawn against deposited funds makes it of even greater importance than, in the case of a bill, that a check should be presented, and that the drawer should be notified of non-payment in order that he may speedily inquire into the causes of refusal, and be placed in a position to secure his funds which were deposited in the bank.' The rule, however, as to the time allowed the holder for presentment of a check, in order to relieve him from the risk of loss by failure of the drawer, is definitely fixed by the authorities: (1) Where the payee to whom the check is delivered receives it in the place where the bank on which it is drawn is located, he must present it by the close of banking hours on the next business day. (2) Where the check, as in this case, is drawn on a bank located at a place distant from that in which it was received by the payee, it must be sent for presentment for payment by mail on the next secular day after it is received, and presented on the next day after its receipt. In this case the check seems to have been forwarded for payment in due time, but it was sent directly to the drawee by mail, with the request that the bank of Richfield remit the amount by mail in exchange on Kansas City. The [payee's bank], therefore, elected the drawee of the check as its agent for collection. That this was negligence is well settled by the authorities. It is said in Daniel on Negotiable Instruments (volume 1, § 328a), 'For the purposes of collection, the collecting bank must employ a suitable subagent. It must not transmit its checks or bills directly to the bank or party by whom payment is to be made, with the request that remittances be made therefor. It is considered that no firm, bank, corporation or individual can be deemed a suitable agent, in contemplation of law, to enforce in behalf of another a claim against itself.' This proposition is sustained by abundant authorities. Drovers' Nat. Bank *v.* Anglo-American Packing & Provision Co., 117 Ill. 100; s. c., 7 N. E. Rep. 601; Bank *v.* Burns, 12 Colo. 539; s. c., 21 Pac. Rep. 714; Bank *v.* Goodman, 109 Pa. St. 422; s. c., 2 Atl. Rep. 687; First Nat. Bank of Evansville *v.* Fourth Nat. Bank of Louisville, 6 C. C. A. 183; s. c., 56 Fed. Rep. 967; Farwell *v.* Curtis, 7 Biss. 160; s. c., Fed. Cases, No. 4,690." It was insisted before the court that inasmuch as the check was forwarded in due time and came into the hands of the drawee, which refused payment, and returned the check with the statement "No funds in bank," the defendant was not injured by the mode of presentment; that an answer of "No funds," sent by mail, was as effectual a refusal to pay as though made across the counter at the bank. To this the court said: "Where due presentment is not made the burden of proof is upon the holder of the check to show that the drawer has not suffered injury." Ford *v.* McClung, 5 W. Va. 166; 2 Pars. Notes & B. 71; 2 Dan. Neg. Inst. § 1588; Daniels *v.* Kyle, 1 Ga. 304.

§ 339. When a bank collecting a draft is liable to the owner.— It was held in the federal court for the district of Indiana that a bank which was an indorsee for collection for

[1] Shipsey *v.* Bowery National Bank, (1875) 59 N. Y. 485.

account of a prior indorsee for collection was liable to the owner of the draft for the amount collected, and not remitted to the owner or the prior indorsee, notwithstanding credit for the amount was given the latter and he charged the collector and credited the owner, and was charged for the same by the owner, and though the collector, by virtue of an agreement with its indorser, whereby the amount due from one to the other for collections was to be placed to the latter's credit with a certain bank, wrote to that bank to place the amount to the credit of the prior indorser, which order it could have countermanded after notice of the latter's failure.[1] In a case in the federal court it appeared that the owners of a bill of exchange sent it to a certain bank indorsed by them for collection. At the time the bank received the bill of exchange it was insolvent, to the knowledge of its managing officer, and on that day, or following morning, it failed. Prior to its failure this bank indorsed the bill of exchange to another bank, which collected it and kept the proceeds, crediting the insolvent bank, which was indebted to it, with the amount collected. The court held that the first bank acquired no title because of its fraud in not disclosing its insolvency, and the collecting bank had no better title, as the owner's indorsement showed that the bank was merely the owner's agent to collect the proceeds.[2]

§ 340. When indorser of a check is relieved of liability.—The question of liability of an indorser of checks drawn payable to his order, by one upon a bank with which the latter kept an account, to the bank in which he placed the checks, they being received as cash as shown by the record of the case, and not for collection by the bank, has been considered in a recent case before the Nebraska Supreme Court. There had been delay in the presentation of the checks, and the court declined to lay down any rule by which the indorsee of a check must present the same for payment in any given time to hold the indorser. But in this

[1] Commercial Nat. Bank of Cincinnati *v.* Hamilton Nat. Bank of Ft. Wayne, (1890) 42 Fed. Rep. 880. See Sweeny *v.* Easter, 1 Wall. 173; Bank of the Metropolis *v.* First Nat. Bank of Jersey City, 19 Fed. Rep. 303; Bank *v.* Armstrong, 39 Fed. Rep. 684; First Nat. Bank of Chicago *v.* Bank, 3 Fed. Rep. 257; Blaine *v.* Bourne, 11 R. I. 119; Bank *v.* Hubbell, 22 N. E. Rep. 1034; White *v.* Bank, 102 U. S. 658.

[2] Peck *v.* First National Bank, (1890) 43 Fed. Rep. 357.

particular case they held that the checks were not presented in a reasonable time.[1]

[1] First National Bank of Wymore *v.* Miller, 37 Neb. 500. The court considered the question as to whether the indorsee was damaged by the delay in presenting the checks was wholly immaterial, upon the rule stated, as they said, in the following cases: "In Northwestern Coal Co. *v.* Bowman & Co., 69 Iowa, 150, the court say, after deciding that the plaintiff had held the check in question an unreasonable time before presenting it, and that it could not recover against indorsers: 'The fact that the drawer had no funds in the hands of the drawee when the check was drawn, makes no difference.' In Gough *v.* Staats, 13 Wend. 549, the Supreme Court of New York say: 'If there has not been due diligence in presenting the check for payment, the indorser is discharged, although he has not been prejudiced by the delay.' The Nebraska court said further: 'The authorities all say that in order to hold an indorser of a check it must be presented by the indorsee in a reasonable time, and as to what is a reasonable time, depends upon the facts and circumstances of each particular case.' The facts in this case were that the checks were placed in the bank about the close of banking hours, on the 31st day of May, 1890. The bank on which they were drawn was in a place twenty-seven miles distant from the location of the bank receiving them, and a mail left the latter place at 6 P. M. daily, arriving at the place where the bank upon which the checks were drawn was located, at 9 P. M. of the same day. The bank receiving the checks made no inquiry of the bank on which they were drawn, as to whether the checks were good, nor did it at any time advise that bank that it held the checks, but on the day of their receipt mailed them to a bank in another state, which bank sent them by mail to a bank in Omaha, Nebraska, which bank in turn sent them by mail to the bank on which they were drawn, they arriving there on June 5, where they were then protested for non-payment. In Smith *v.* Janes, 20 Wend. 192, the Supreme Court of New York say: 'The holder of a check can recover against the indorser only when he has used due diligence in presenting or giving notice of demand and non payment. * * * Where the parties all reside in the same place, the check should be presented on the day it is received, or on the following day; and when payable at a different place from that in which it is negotiated, it should be forwarded by the mail on the same or the next succeeding day for presentment.' See, also, Holmes *v.* Roe, 62 Mich. 199. In Mohawk Bank *v.* Broderick, 10 Wend. 304, the Supreme Court of New York say: 'A check on a bank for the payment of money, to charge an indorser, must be presented with all dispatch and diligence consistent with the transaction of other commercial concerns, and it was accordingly held, where a check was received in Schenectady on the 14th of January, drawn on a bank in Albany, a distance of sixteen miles from the former place, and between which places there is a daily mail, and not presented until the 6th of February, that laches was imputable to the holder, and that the indorser was discharged. Although it is said that checks are like inland bills of exchange, and are to be governed by the same principles, greater diligence is required in presenting them than in presenting bills of exchange.' This case was affirmed by the Court for the Correction of Errors in 13 Wend. 133. See to the same effect Northwestern Coal Co. *v.* Bowman, 69 Iowa, 150."

End of Volume I.

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A TREATISE ON THE LAW

PERTAINING TO

CORPORATE FINANCE

INCLUDING

THE FINANCIAL OPERATIONS AND ARRANGEMENTS

OF PUBLIC AND PRIVATE CORPORATIONS

AS DETERMINED BY

THE COURTS AND STATUTES

OF THE UNITED STATES AND ENGLAND

By

WILLIAM A. REID

OF THE NEW YORK BAR

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VOL. II

ALBANY

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§ 341. Rules generally.— No better evidence need be produced to prove the insolvency of a bank than a return of *nulla bona* made by a sheriff upon executions issued against it.[1] A check does not become absolutely and under all circumstances the property of a bank when deposited in it for collection and the bank gives credit for it upon its books. Should the bank fail while the check is still in its hands and before it has been sent out for collection, it may be recalled by the depositor. If in such case, a receiver be appointed for the bank and the depositor demands the check of him, the receiver ought to charge the account of the depositor with the amount and return the check to the depositor.[2] Among other questions before the federal courts growing out of the insolvency of this national bank and the right to various assets coming into the hands of its receiver,

[1] Wheelock *v.* Kost, (1875) 77 Ill. 296.

[2] Balbach *v.* Frelinghuysen, 6 N. J. Law J. 105.

was this, whether a bank, which had sent it a draft for collection, which it in turn remitted to its correspondent bank at the residence of the owner, and the draft was paid to the latter, the latter not having remitted to the insolvent bank or the latter given the owner of the draft credit for the avails up to the time it was declared insolvent, could recover the proceeds of this collection from the correspondent bank. The United States Circuit Court for the district of Massachusetts held that, until this remittance was made, or the principal bank had given the original owner of the draft credit for the avails, the original owner of the draft, as the owner of the proceeds thereof, was entitled to recover them from the correspondent bank. That though the correspondent was the agent of the bank sending it the draft, and payment to it was to that extent a payment to the principal, yet, until the proceeds were actually remitted to such principal, and mingled with its general funds, or were so credited, the owner of the draft had the option to decline to consider it his debtor, and to claim the proceeds in the hands of the agent, and when the principal failed, and a receiver was appointed, the receiver took the proceeds of the draft when remitted to him, subject to the same right of reclamation by the owner that the latter had as against the agent.[1] A national bank becoming insolvent and being placed in the hands of a receiver, pursuant to the National Banking Association Act, the rights and liabilities of debtors and creditors of the bank become fixed at the appointment of the receiver, and upon his appointment its property is subject, after prior government claims, if any, to disposal and ratable distribution, upon principles of equity, among all its general creditors.[2] Upon the insolvency of a bank, and its affairs going into the hands of a receiver, general depositors must be paid *pro rata*.[3] In the event of a bank becoming insolvent and its affairs being administered through a receivership, one who has made a general deposit of trust funds in it, in good faith on the part of himself and the bank, establishing the relation of debtor and creditor between them, can be given no preference over other general depositors.[4] It appeared in a New Jersey case that on a

[1] National Exchange Bank of Dallas *v.* Beal, (1892) 50 Fed. Rep. 355; affirmed in Beal *v.* National Exchange Bank of Dallas, (1893) 55 Fed. Rep. 894.

[2] Balch *v.* Wilson, 25 Minn. 299.

[3] McLain *v.* Wallace, (1885) 103 Ind. 562.

[4] Fletcher *v.* Sharpe, (1886) 108 Ind. 276.

certain day the directors of a bank discovered that its cashier had embezzled its funds, but not to such an extent, as they then supposed, as to render the bank insolvent, and the bank continued business. The next day a customer of the bank deposited with the bank about $600 in cash and checks, which were credited in his bank book, and the checks duly forwarded for collection, and credited to the bank by its correspondent. The next day the bank suspended through insolvency. The claim of this depositor was held to have no preference in payment over those of other depositors.[1] In its control of a savings bank, in a deficiency of assets to pay its depositors in full, the New Jersey Chancery Court held that a deposit in the bank, under a family agreement, of a sum of money, to pay $1,460 per annum to the widow for life, and the surplus of income from such deposit, if any, to her children, which the bank had received under authority of its charter to accept and execute any trusts committed to it, by any person, by will or otherwise, or by order of any court, was not entitled to preference in payment over others; that, even if the trust claimed for it had been shown, nothing in the charter of the bank gave the fund the priority claimed for it, and it would not be entitled to it.[2] A state court is not deprived by anything in the National Banking Association Law of jurisdiction to determine and segregate a trust fund held by the receiver of an insolvent national bank, and to render judgment for a proper disposal of the fund in accordance with the trust.[3] An indorser of a promissory note, in an action against him by the receiver of an insolvent national bank, cannot defend by a claim of set-off for money deposited in the bank.[4] The United States Circuit Court

[1] Terhune *v.* Bank of Bergen County, 7 Stew. Eq. (N. J.) 367.

[2] Vail *v.* Newark Savings Institution, 5 Stew. Eq. (N. J.) 627. As to the liabilities of a national banking association to which its assets when in the hands of a receiver will be applied and ratably divided among, see Turner *v.* First National Bank, 26 Iowa, 562. For a case holding that where money had been placed with a bank for payment of certain bonds issued by a public corporation, but the owner of the bonds had not presented them for payment when they fell due, and the bank failed, the loss should fall upon the corporation issuing the bonds, and not upon the holder of the bonds, see Adams *v.* Hackensack Improvement Commission, 15 Vroom (N. J.), 638.

[3] Flint Road Cart Co. *v.* Stephens, (1888) 32 Mo. App. 341. As to a state court's jurisdiction to follow the proceeds of certain drafts in the hands of a receiver of a national bank as trust property and to decree their payment to the parties entitled, see Tuttle *v.* Frelinghuysen, 11 Stew. Eq. (N. J.) 12.

[4] Stephens, Receiver, *v.* Schuchmann, (1888) 32 Mo. App. 333.

of Appeals for the third circuit has held that the indorser of a note which is discounted by a national bank, and which matures after the bank becomes insolvent and a receiver was appointed, was entitled to set off against the note the amount of his deposits in the bank at the time of its failure.[1] In an action by the receiver of a national bank upon a note due the bank from two persons jointly, at the time of his appointment, the Minnesota Supreme Court held that promissory notes not due at the time of the appointment of the receiver, upon which the bank and others were liable as makers, and owned at that time by one of the defendants only, and originating in a different transaction, could not be offset against the claim of the receiver on the joint note.[2] In case of an assignment of a bank for the benefit of creditors

[1] Yardley *v.* Clothier, (1892) 51 Fed. Rep. 506, affirming 49 Fed. Rep. 337. The court cited and commented upon Skiles *v.* Houston, 110 Pa. St. 254; s. c., 2 Atl. Rep. 30; Bosler's Admr. *v.* Bank, 4 Pa. St. 32; In re Middle Dist. Bank, 1 Paige, 584; Van Waggoner *v.* Gas Light Co., 23 N. J. Law, 283; Hade *v.* McVay, 31 Ohio St. 231; Clarke *v.* Hawkins, 5 R. I. 224; Balbach *v.* Frelinghuysen, 15 Fed. Rep. 685, and disapproved of Armstrong *v.* Scott, 36 Fed. Rep. 63, and Stephens *v.* Schuchmann, 32 Mo. App. 333.

[2] Balch *v.* Wilson, 25 Minn. 299. In Scnierenberg *v.* Stephens, (1888) 32 Mo. App. 314, and Nichols *v.* Stephens, (1888) 32 Mo. App. 330, it appeared that a national bank had determined in due form to increase its capital stock from $300,000 to $500,000, but the new stock subscriptions never exceeded the sum of $130,000, whereupon the bank advertised an increase to $430,000, but this assumed increase was never authorized by a vote of the stockholders and was never certified to the United States comptroller of the currency, or by him approved or certified. The plaintiffs in these suits had subscribed and paid in certain sums for so much of the proposed addition to the original stock of $200,000. The bank becoming insolvent, it was held that the plaintiffs never became stockholders, and were entitled to be treated as creditors to the amount paid in by them and to have judgment against the receiver for payment of the same in due course of his administration of the assets of the bank. In Flint Road Cart Co. *v.* Stephens, (1888) 32 Mo. App. 341, it appeared that a sum of money had been placed in the hands of the cashier of an insolvent national bank to indemnify him as surety on an attachment bond in behalf of the cart company. The cashier had mingled it with the bank's funds so that it went with the assets of the bank into the hands of the receiver. It was held that the sum of money was a trust fund separate from the general assets of the bank, and upon the discharge of the surety's obligation the company was entitled to recover it from the receiver without any reference to his administration upon the claims of the bank's creditors. For a case showing under what circumstances a contract with other parties by the cashier of a bank which subsequently became insolvent would inure to the benefit of the bank, see Hayes *v.* Orr, (1891) 47 Fed. Rep. 286.

the holders of its notes are entitled to a preference over the holders of certificates of deposit.[1] The noteholders of a bank, after a demand and refusal, will be entitled to interest on their claims in preference to depositors.[2] Where a state bank, organized as a national bank, becomes insolvent, a judgment debt due to it as a national bank cannot be paid in the notes of the old state bank.[3] Where a bank orders its correspondent bank to place to its credit with another bank the balance due it, and by mistake the correspondent places an amount in excess of what is due to the credit of that bank, upon an assignment by the latter, and its assignee receiving the amount from the bank with which it had been credited, the bank making the mistake may recover this excess from the assignee of the assigning bank.[4] Upon stopping payment by a national bank, a debtor to the bank cannot set off a claim subsequently assigned to him.[5] It has been held in the federal court for the eastern district of Virginia that where insolvent debtors of an insolvent national bank assign, giving preferences in favor of the bank, where there is nothing in the language of the assignment, or in the circumstances under which the debt was created, to negative the presumption that the debt should bear interest, and nothing in the conduct of the receiver of the national bank to estop him from claiming interest, interest must be paid.[6]

§ 342. Appointment of a receiver for national bank.— The power vested in the comptroller of the currency by the National Banking Act, authorizing him, whenever he becomes satisfied of the insolvency of a national bank, to appoint a receiver, has been held to be discretionary, and his decision as to the insolvency of a bank, for the purpose of such an appointment, held to be final and not reviewable by the court. And the comptroller's right to appoint a receiver under that act is not affected by the right given to stockholders of national banks by United States Revised Statutes, section 5220, to put a bank in voluntary liquidation. Neither is the power of the comptroller to take action,

[1] Pennsylvania Bank Assignees' Account, 39 Pa. St. 103.

[2] Bank of Pennsylvania's Estate, 60 Pa. St. 471.

[3] Thorp *v.* Wegefarth, 56 Pa. St. 82.

[4] First Nat. Bank of Omaha *v.* Mastin Bank, (1880) 48 Fed. Rep. 433.

[5] Venango Bank *v.* Taylor, 56 Pa. St. 14.

[6] Bain *v.* Peters, (1890) 44 Fed. Rep.

before the bank ceases to do a banking business, limited by the provision of the statute, that after the receiver has had charge of the bank long enough to pay all its debts the stockholders may select an agent to take charge of such assets as remain. And the provision of the act, authorizing the appointment of a receiver by the comptroller to "close up" a national banking association, contemplates the liquidation and final winding up of the business of the bank, not the mere closing of the bank, and does not limit the power of the comptroller to take action before the bank has closed its doors.[1]

§ 343. When an appointment of receiver of a bank is not authorized.— A demurrer to an action brought by one appointed by a court receiver of a bank in California was sustained in the United States Circuit Court for that district. The court held that the statute of that state authorizing the attorney-general, on the recommendation of the bank commissioners, to institute suit to enjoin any bank guilty of violating the banking laws from doing further business, and if the bank be found insolvent to cause its business to be wound up under the direction of the bank commissioners, did not authorize the court to appoint a receiver for the bank; and a receiver appointed in such a proceeding and manner was without authority to maintain a suit to collect claims of the bank. It was further held that the statute of the state providing that upon the "dissolution of any corporation" a receiver may be appointed on the application of creditors or stockholders, did not apply to the case of an insolvent bank which the state was proceeding against for violating its charter.[2]

§ 344. Powers of a receiver for a national bank.—Section 5234 of the United States Revised Statutes, referring to receivers appointed for national banking associations becoming insolvent, provides as follows: "Such receiver, under the direction of the comptroller, shall take possession of the books, records and assets of every description of such association, collect

[1] Washington Nat. Bank of Tacoma v. Eckels, (1893) 57 Fed. Rep. 870.

[2] Murray v. American Surety Co. of New York, (1894) 59 Fed. Rep. 345; reaffirmed in Murray v. American Surety Co. of New York, (1894) 61 Fed. Rep. 273.

all debts due and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association on such terms as the court shall direct, and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders." An application was made in the United States District Court for the southern district of California for an order authorizing the receiver of an insolvent national banking association within that jurisdiction to compound the statutory liability of certain of its stockholders. Ross, D. J., denied the petition.[1]

§ 345. Actions of such receivers — rules.— A receiver of a national bank may sue in the United States Circuit Court to recover an indebtedness owing to the bank, without regard to the amount involved.[2] A national bank which had pledged nego-

[1] In re Certain Stockholders of the California Nat. Bank of San Diego, (1892) 53 Fed. Rep. 38. These were the reasons given for the court's action: "Assuming that the court is authorized to grant the order asked for, it is unhesitatingly refused. To sanction proceedings by which a stockholder in a national banking association fraudulently puts away his property for the purpose of avoiding his just and legal obligations as such stockholder, and is then permitted to compromise his liability for the payment of a less sum than is due, is to place a premium upon fraud. With such conduct there should be no compromise. Laws are made to be observed and enforced, and every one should be made to know that, in respect to every contract made pursuant to these provisions, the government will accord and exact fair dealing and the utmost good faith. It is far better that the entire amount of the obligations of the stockholders in question should be lost to the trust fund than that the slightest judicial countenance should be given the proposed proceedings. The liability of the stockholders of the insolvent bank is several, not joint. Kennedy v. Gibson, 8 Wall. 505. And there is no reason why the property of every one who has conveyed or may convey it for the fraudulent purpose of avoiding his first and legal obligations arising under the law should not be followed and every reason why it should be. * * * It is, however, to say the least, extremely doubtful whether the court has the power to authorize the compromising of the statutory liability of a stockholder in a national bank. * * * It is by no means clear that the statutory liability of the stockholders is a debt within the meaning of the clause authorizing the court to sanction the compounding of all bad or doubtful debts." This point, however, was not decided, it not being necessary.

[2] Yardley v. Dickson, (1891) 47 Fed. Rep. 835. See U. S. v. Mooney, 116 U. S. 104; s. c., 6 Sup. Ct. Rep. 304; Kennedy v. Gibson, 8 Wall. 498; Frelinghuysen v. Baldwin, 12 Fed. Rep. 395; Platt v. Beach, 2 Ben. 303; Stanton v. Wilkeson, 8 Ben. 357; Price v. Abbott, 17 Fed. Rep. 506; U. S. v. Shaw, 39

tiable notes to another bank to secure a loan became insolvent. The bank to which the notes had been pledged held them after a receiver for the insolvent bank had been appointed, still taking steps to collect them on account of a balance of its loan. Those who had obtained judgments against the insolvent bank in the state courts had by garnishment proceedings sought to enforce their claims against the proceeds of these notes in the hands of the bank holding them. The Circuit Court of the United States, in which the receiver brought his action in equity against this bank, and the creditors endeavoring to enforce their claims against the insolvent bank in the state courts, to recover the control of these notes as a part of the assets of the insolvent bank, that he might distribute the proceeds as other assets, upon a demurrer filed by the respondents, sustained the jurisdiction of the Court of Equity in the matter.[1] The receiver of an insolvent national bank, it has been held, may at any time dismiss an attorney employed by him, regularly or otherwise, to prosecute claims of the bank, and employ another in his place, when the court will, by order, substitute him in the place of the dismissed attorney, except as to such cases as the latter may have commenced and finished. But where a contract has been entered into between the receiver and the attorney that the latter should receive the attorney's fees provided for in the notes he was employed to collect, the court will not direct the substitution of another attorney in unfinished cases until the receiver deposits the amount of the attorney's fees reserved in the notes as a security to the dismissed attorney for such services as he may have rendered.[2] The maker of a note upon which the receiver of a national bank has brought action may plead as set-off any debt of the bank to him existing at the time of its failure, as the receiver takes the choses in action belonging to the bank subject to all claims and defenses which might have been interposed as against the bank before the liens of the United States and general creditors attached.[3] Where a bank has received the proceeds of a fraudulent sale of stock belonging to it, the fact that a receiver for the bank is subse-

Fed. Rep. 433; Mitchell *v.* Walker, 2 Browne Nat. Bank Cas. 180; Hendee *v.* Railroad Co., 26 Fed. Rep. 677.

[1] Chase *v.* Cannon, (1891) 47 Fed. Rep. 674, the court considering the case in its important features similar to Bank *v.* Mixter, 124 U. S. 721; s. c., 8 Sup. Ct. Rep. 718.

[2] In re Herman, (1892) 50 Fed. Rep. 517.

[3] Adams *v.* Spokane Drug Co., (1893) 57 Fed. Rep. 888, following Yardley *v.*

quently appointed does not give its creditors such right in the proceeds as will prevent the purchaser of the stock rescinding the order and requiring restitution.[1] A state bank of Ohio discounted its note payable to the order of its cashier and indorsed by him with a national bank in Ohio for a sum of money which was to remain on deposit to the credit of the former bank in the latter, subject to its check. It had drawn but a small amount of this deposit when the national bank was taken in charge by the comptroller of the currency, on account of its insolvency, and placed in the hands of a receiver for the purpose of winding up its affairs. The receiver brought action against the state bank and its cashier upon its note. The bank claimed the right to set off the balance on deposit, tendering the amount which it had drawn by its checks. Judgment upon a demurrer to the answers was given in favor of the receiver. The bank then filed its bill in equity for injunction to restrain the collection of the judgment, and claiming the same right to set-off. This bill was dismissed on demurrer in the United States District Court, and among others, upon appeal to the United States Circuit Court of Appeals the latter court certified to the United States Supreme Court, for its opinion, the following question: "Where a national bank becomes insolvent, and its assets pass into the hands of a receiver appointed by the comptroller of the currency, can a debtor of the bank set off against this indebtedness the amount of a claim he holds against the bank, supposing the debt due from the bank to have been payable at the time of its suspension, but that due to it to have been payable at a time subsequent thereto?" The Supreme Court of the United States answered this question affirmatively.[2]

Clothier, 49 Fed. Rep. 337; Pauly *v.* State Loan & Trust Co., 56 Fed. Rep. 430; affirmed by United States Circuit Court of Appeals in Pauly *v.* State Loan & Trust Co., 58 Fed. Rep. 666.

[1] Merrill *v.* Florida Land Imp. Co., (1893) 60 Fed. Rep. 17, affirming 52 Fed. Rep. 77; s. c., 2 C. C. A. 629; 2 U. S. App. 434.

[2] Farmers & Merchants' State Bank *v.* Armstrong, (1892) 146 U. S. 499. The charter of the national bank was forfeited and the bank dissolved by a decree of the Circuit Court, July 12, 1887, when title to its assets was necessarily thereby transferred to the receiver. National Bank *v.* Colby, 21 Wall. 609. After stating this fact, FULLER, Ch. J., speaking for the court, *arguendo*, said: "The note in controversy did not mature until September 7, 1887, but the deposit to the credit of the Farmers' Bank was due for the purposes of suit upon the closing of the Fidelity Bank [the one in hands of receiver], as under such circumstances no demand was necessary. The receiver took the assets of

§ 346. Actions to control the conduct of such receivers.—The United States Circuit Court for the western district of Washington sustained the removal of a suit from the state court, the object of which suit was to control the action of the receiver of a national bank appointed by the comptroller of the currency. It was held that in such an action, to secure the application of

the Fidelity Bank as a mere trustee for creditors, and not for value and without notice, and, in the absence of statutes to the contrary, subject to all claims and defenses that might have been interposed as against the insolvent corporation before the liens of the United States and of the general creditors attached. The right to assert set-off at law is of statutory creation, but courts of equity, from a very early day, were accustomed to grant relief in that regard independently as well as in aid of statutes upon the subject. In equity, relief was usually accorded, says Mr. Justice STORY (Eq. Jur. § 2435), 'where, although there are natural and independent debts, yet there is a natural credit between the parties, founded, at the time, upon the existence of some debts due by the crediting party to the other. By natural credit, in the sense in which the terms are here used, we are to understand, a knowledge on both sides of an existing debt due to one party, and a credit by the other party, founded on and trusting to such debt, as a means of discharging it.' This definition is hardly broad enough to cover all the cases where, as the learned commentator concedes, there being a 'connection between the demands, equity acts upon it, and allows a set-off under particular circumstances.' § 1434. Courts of equity frequently deviate from the strict rules of mutuality when the justice of the particular case requires it, and the ordinary rule is that where the mutual obligations have grown out of the same transaction, insolvency on the one hand justifies the set off of the debt due upon the other. Blount *v.* Windley, 95 U. S. 173, 177. In Carr *v.* Hamilton, 129 U. S. 252, 262, it was decided that, when a life insurance company becomes insolvent and goes into liquidation, the amount due on an endowment policy, payable in any event at a fixed time, may, in settling the company's affairs, be set off against the amount due on a mortgage deed from the holder of the policy to the company by way of compensation; and Mr. Justice BRADLEY, delivering the opinion of the court said: 'We are inclined to the view that where the holder of a life insurance policy borrows money of the insurer, it will be presumed, *prima facie*, that he does so on the faith of the insurance and on the expectation of possibly meeting his own obligation to the company by that of the company to him, and that the case is one of mutual credits, and entitled to the privilege of compensation or set-off whenever the mutual liquidation of the demands is judicially decreed on the insolvency of the company.' And the case of Scammon *v.* Kimball, 92 U. S. 362, was referred to, where it was held that a bank, having insurance in a company which was rendered insolvent by the Chicago fire of 1871, had a right to set off the amount of his [its?] insurance on property consumed against money of the company in his [its?] hands on deposit, although the insurance was not a debt due at the time of the insolvency. Indeed, natural justice would seem to require that where the transaction is such as to raise the presumption of an agreement for a set-off, it should be held that the equity that this should be done is superior to any subsequent equity not arising out of a purchase for value without notice. In the case at bar the credits between the banks were reciprocal and were parts of the same transaction, in which each gave credit to the other on the faith of the simultaneous credit, and the principle applicable to mutual credits applied. It was, therefore, the balance upon an adjustment of the accounts which was the debt, and the Farmers' Bank had the right as against the receiver of the Fidelity Bank, although the note matured after the suspension of the bank, to set off the balance due upon its deposit account, unless the provisions of the National Banking Law were to the contrary. * * * The argument is that [sections 5234, 5236 and 5242, Rev. Stats. U. S.] by implication forbid this set-off because they require that after the redemption of the circulating notes has been fully provided for, the assets shall be ratably distributed among the creditors, and that no preferences given or suffered, in contemplation of or after committing the act of insolvency, shall stand. And it is insisted that the assets of the bank, existing at the time of the act of insolvency, include all its property without regard to any existing liens thereon or set-off thereto. We do not regard this position as tenable. Undoubtedly, any disposition by a national bank, being insolvent or in contemplation of insolvency, of its choses in action, securities or other assets made to prevent their application to the payment of its circulating notes, or to prefer one creditor to another, is forbidden; but liens, equities or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated. The provisions of the act are not directed against all liens, securities, pledges or equities, whereby one creditor may obtain a greater payment than another, but against those given or arising after or in contemplation of insolvency. Where a set-off is otherwise valid, it is not perceived how its allowance can be considered a preference, and it is clear that it is only the balance, if any, after the set-off is deducted which can justly be held to form a part of the assets of the insolvent. The requirement as to ratable dividends is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank. There is nothing new in this view of ratable distribution, As pointed out by counsel, the bankruptcy act of 13 Eliz., chap. 7, contained no provision in any way directing a set-off or the striking of a balance, and by its second section, commissioners in bankruptcy were to seize and appraise the lands, goods, money and chattels of the bankrupt, to sell the lands and chattels, or otherwise to order the same for the satisfaction and payment of the said creditors a portion, rate and rate alike, according to the quantity of his or

part of the funds in the hands of a receiver appointed by the comptroller of the currency in satisfaction of plaintiff's claim against the insolvent bank for money received by it as collecting agent, the bank was only a nominal party, the receiver being the one to be held accountable for any unauthorized disposition of the money sued for; and, since the object of this suit was to control

the official conduct of the receiver, appointed under the authority of the national banking laws, and his defense must rest on the interpretation of those laws, the case was within the jurisdiction of the federal Circuit Court as being one "arising under the * * * laws of the United States."[1]

§ 347. What a receiver cannot set off in an action to recover trust funds coming into his hands.— The United States Circuit Court of Appeals for the third circuit affirmed the holding of the court below in this case, that the debts of a partner and his firm to a bank could not, in equity, be set off by a receiver of a bank against trust moneys which the partner, after

their debts. 4 Statutes of the Realm, part 1, 539. Yet in the earliest reported decisions upon set-off it was allowed under this statute. Anonymous, 1 Mod. 215; Curson *v.* African Co., 1 Vern. 121; Chapman *v.* Derby, 2 Vern. 117. The succeeding statutes were but in recognition, in bankruptcy and otherwise, of the practice in chancery in the settlement of estates, and it may be said that in the distribution of the assets of insolvents under voluntary or statutory trusts for creditors, the set off of debts due has been universally conceded. The equity of equality among creditors is either found inapplicable to such set-offs or yields to their superior equity. We are dealing in this case with an equitable set-off, but if on June 20 [the day the bank was ordered closed] the note had matured and each party had a cause of action capable of enforcement by suit at once, upon the argument for the receiver, the legal set off would be destroyed just as effectually as it is contended the equitable set-off is. We cannot believe congress intended such a result, or to destroy by implication any right vested at the time of the suspension of a national bank. The state of case where the claim sought to be offset is acquired after the act of insolvency is far otherwise, for the rights of the parties become fixed as of that time, and to sustain such a transfer would defeat the object of these provisions. The transaction must necessarily be held to have been entered into with the intention to produce its natural result, the preventing of the application of the insolvent's assets in the manner prescribed. Venango National Bank *v.* Taylor, 56 Pa. St. 14; Colt *v.* Brown, 12 Gray, 233. Our conclusion is that this set-off should have been allowed, and this has heretofore been so held in well-considered cases. Snyder's Sons Co. *v.* Armstrong, 37 Fed. Rep. 18; Yardley *v.* Clothier, 49 Fed. Rep. 337; Armstrong *v.* Warner, 21 Weekly L. Bull. 136; 27 Weekly L. Bull. 100."

[1] Grant *v.* Spokane Nat. Bank, (1891) 47 Fed. Rep. 673; citing Armstrong *v.* Ettlesohn, 36 Fed. Rep. 209; Armstrong *v.* Trautman, 36 Fed. Rep. 275; McConville *v.* Gilmour, 36 Fed. Rep. 277; Sowles *v.* Witters, 43 Fed. Rep. 700; Tennessee *v.* Davis, 100 U. S. 257–264; Railroad Co. *v.* Mississippi, 102 U. S. 135–141; Removal Cases, 115 U. S. 11; s. c., 5 Sup. Ct. Rep. 1113; Bachrack *v.* Norton, 132 U. S. 337; s. c., 10 Sup. Ct. Rep. 106; Feibelman *v.* Packard, 109 U. S. 421–423; s. c., 3 Sup. Ct. Rep. 289; Reagan *v.* Aiken, 138 U. S. 109; s. c., 11 Sup. Ct. Rep. 283; Bock *v.* Perkins, 139 U. S. 630; s. c., 11 Sup. Ct. Rep. 677.

the debts were contracted, mingled with the firm's deposits without the bank's knowledge, and the whole amount of which remained continuously in the bank until it failed.[1]

§ 348. When a receiver cannot question the disposition of funds coming into the hands of a clearing house association.— It appeared in this case that, by special agreement, a national bank of Philadelphia, instead of the usual deposit of securities as collateral for payment of its daily balance at the clearing house of that city, each day left with the manager of the clearing house all checks drawn on it, and other evidences of its indebtedness received from other banks, to be held until the balance due from it for the day was paid. While certain checks and other evidences of its indebtedness were so held, the bank was closed by the comptroller of the currency. Upon this happening the clearing house collected the amount of the checks and other evidences of indebtedness from the banks from which they

[1] Fisher *v.* Knight, (1894) 61 Fed. Rep. 491, affirming Knight *v.* Fisher, (1893) 58 Fed. Rep. 991. Acheson, Circuit Judge, *arguendo*, said: "There is abundant authority for the doctrine that the real ownership of a fund deposited in a bank may be shown to be in another than the person in whose name the deposit is made; and the fund recovered from the bank by the true owner, if the bank has not been misled or prejudiced by the apparent ownership. Frazier *v.* Bank, 8 Watts & S. 18; Stair *v.* Bank, 55 Pa. St. 364; Bank *v.* King, 57 Pa. St. 202. Upon the admitted facts, and under the authorities, we are of the opinion that the fund in controversy belonged to the plaintiff and was recoverable by him from the bank or its receiver. The court below was clearly right in holding that the defendant could not set off against the plaintiff's claim the liability of N. T. Lewis as a stockholder of the bank, or the amount of the note for one thousand dollars. The liability of Lewis upon his assessment was altogether his individual debt, and in no view of the case was it a proper set-off. Norcross *v.* Benton, 38 Pa. St. 217. Neither the bank nor the receiver had done anything upon the faith of the apparent ownership of the fund, and neither was prejudiced in consequence of the deposit having been made in the name of N. T. Lewis & Son. The note was not taken on the credit of the deposit. It was discounted thirty days before the plaintiff's money came into the bank. Nearly two months had elapsed after the closing of the bank before the note matured. The bank had no lien upon the deposit for a debt not due. Jordan *v.* Bank, 74 N. Y. 467, 472. The rights of the parties were fixed upon the insolvency of the bank and the appointment of the receiver. As the defendant had no right then to apply the plaintiff's money to pay the debt of N. T. Lewis & Son, he has no such right now. Certainly, the mere delay of the plaintiff in bringing suit until after the maturity of the note did not change the situation."

had been received, and from the amount realized paid, besides the bank's balance for the day, due bills given by it for its balances for the preceding day, by their terms payable only through the clearing house the day after issue, and actually in the exchanges held when the bank closed, and applied the remainder towards cancellation of clearing house loan certificates issued to the bank under an agreement between the banks whereby any loss from failure of one to pay such certificates was chargeable upon the others. The receiver of the insolvent bank instituted a suit against the clearing house committee of the Clearing House Association to recover those checks or the money collected thereon, and had a decree in his favor in the Circuit Court. Upon appeal to the United States Circuit Court of Appeals for the third circuit, the appellate court held that, as the transaction on the part of the bank was not in contemplation of insolvency, nor with a purpose to give a preference, or to prevent application of its assets as prescribed by law, the exchange between the banks was valid, and that it was not avoided, nor were the rights of the clearing house or of the creditor banks impaired by what subsequently occurred. Therefore, the receiver of the bank, taking its assets subject to all equities and rights against it, had no equity, in his suit, to question the appropriation of the money paid by the other banks.[1]

§ 349. Attachment of property of an insolvent bank — retains its lien against a receiver of the bank subsequently appointed.— A receiver of a bank in Nebraska made a motion to dissolve an attachment which had been levied upon real estate belonging to the bank in the suit of a depositor for the amount of his deposit. The motion was tried upon a stipulation of facts which showed that the attachment was levied properly upon the thirteenth of November; that the bank was then unable to pay its obligations; that before noon of that day the bank suspended business, and posted on its doors a notice as follows: "Bank closed; in hands of receiver; depositors will be paid in full;" that on the morning of that date the managers of the bank telegraphed to the "state banking board" that the bank was closed, and asked the board to send a receiver; that on the four-

[1] Philler *v.* Yardley, (GREEN, D. J., reversing Yardley *v.* Philler, 58 Fed. dissenting) (1894) 62 Fed Rep. 645, Rep. 746.

teenth of November the bank was duly examined by an examiner appointed by the "state banking board," and that on the nineteenth of November the receiver of the bank was appointed by the court. The contention of the receiver was that after the bank suspended business and closed its doors on the thirteenth its property was not subject to attachment at the suit of a creditor, but that all the bank's assets from that moment became a trust fund, to be divided *pro rata* among all the bank's creditors; or, if the property of the bank was subject to attachment on the thirteenth, then the appointment of a receiver on the nineteenth vacated the attachment. The Supreme Court of that state held that the lien acquired by the creditor of the bank on the real estate of the bank by the levy of his attachment thereon was not dissolved by the appointment of a receiver to take charge of the assets of the bank, and, as the creditor's lien was acquired prior to the appointment of the receiver, that officer took the property attached incumbered with the lien.[1]

[1] Arnold *v.* Weimer, (Neb. 1894) 58 N. W. Rep. 709. In disposing of the contention of the receiver the court first showed that there was no express statute or provision in the State Banking Act which sustained his contention, and then proceeded to discuss the questions involved in these words: "Another argument of the receiver is that, inasmuch as the assets of a national bank are not liable to be attached at the suit of a creditor, the legislature must have intended, by the enactment of the Banking Law of this state, that the assets of an insolvent banking association, from the moment of its insolvency, should occupy the same status as the assets of an insolvent national bank. If the legislature had intended by the Banking Act to render the property of an insolvent bank exempt from an attachment of the suit of one of its creditors, it would doubtless have said so. The National Banking Act expressly provides that the United States shall have a first and paramount lien upon all the assets of the bank, and that no attachment shall be issued against said association or its property till the final judgment rendered in the suit brought. Counsel for the receiver cites us to State *v.* Commercial State Bank, 28 Neb. 677; s. c., 44 N. W. Rep. 998, as an authority for the contention. In that case one McConaughy was a large stockholder in the Commercial State Bank. He (McConaughy) became insolvent, and made an assignment to the sheriff for the benefit of his (McConaughy's) creditors. The sheriff took possession of not only McConaughy's property, but claimed the right to the possession of the assets of the bank as well. The attorney-general made application to this court for the appointment of a receiver for the assets of the bank. The sheriff, as McConaughy's assignee, resisted the application, claiming that McConaughy owned all the stock in the bank. The court, by the present Chief Justice NORVAL, held, in effect, that, although McConaughy was the owner of the majority of all the stock of the corporation, he did not thereby

§ 350. Claims against an insolvent bank — jurisdiction of court appointing receiver.—A bank in the state of Michigan presenting a claim for a note which had been rediscounted with it and indorsed by a savings bank of that state to a receiver in whose hands the latter was under the banking laws of that state for winding up its affairs, and being refused payment by the receiver, petitioned the Circuit Court praying that an issue might be framed for the trial of the liability of the insolvent bank to the former on the note to be entered upon the law side of the court. This petition was refused on the ground that under the General Banking Law of the state the court had no jurisdiction in the matter,

become the corporation; and that while his assignee could hold his (McConaughy's) property, the assignee had no claim to the assets of the bank; that they were a trust fund for the payment of its debts, and that the rights of creditors to the bank's property were superior to the rights of the stockholders and the assignee of the stockholders thereto. Nothing in that case supports the contention made by the receiver. There being no statutory provision which exempts the property of this bank from attachment at the suit of one of its creditors prior to the appointment of a receiver therefor, or possession taken by the sheriff under [the statute of this state], and no provision creating an attachment already levied upon the appointment of a receiver for its assets, we proceed to inquire what right or title the receiver acquired to the property attached by virtue of his appointment. [Our statute] provides that the order of attachment shall bind the property attached from the time of the service of the order. * * * In Beach on Receivers (§ 202) it is said: 'It is a general rule that the receiver obtains title subject to all liens previously acquired, but this rule is applicable only to property which is subject to levy and sale under execution. As to other property — such, for example, as equitable interests — the commencement of the action for the appointment of a receiver creates a lien in favor of the plaintiff.' The real estate attached [in this suit] was subject to levy and sale under execution. The legal title to this property was in the bank. A question very similar to the one at bar arose and was decided in Hubbard *v.* President, etc., 7 Met. (Mass.) 340. In that case the Phœnix Bank stopped payment on the 3d day of October, 1842, and afterwards, on the same day, the Hamilton Bank brought suit against the Phœnix Bank in the Common Pleas Court in Suffolk county, and had an attachment issued and levied upon the real and personal property of the Phœnix Bank. On the sixth of October, 'on the application of the bank commissioners,' the Supreme Court of Massachusetts issued an injunction restraining the Phœnix Bank from transacting any further business until a hearing could be had. On the eighteenth of October the Supreme Court appointed a receiver to take possession of the assets of the Phœnix Bank. The receiver then filed a petition in the Supreme Court praying it to enjoin the Hamilton County Bank from further prosecuting its suit at law against the Phœnix Bank, and to dissolve the attachment levied upon the property of the Phœnix Bank. The court, by DEWEY, J., said: 'This leads us directly to the consideration

but that the remedy of the bank was by suit in the usual form against the insolvent bank. The bank applied to the Supreme Court of the state for a *mandamus* to compel the Circuit Court to order such issue to be framed and proceed to the trial of the cause. There was a contention on the hearing that, inasmuch as the state itself did not expressly confer power upon the court appointing the receiver to take cognizance of the claims presented for allowance against the insolvent savings bank, therefore, no such power could be exercised by the Circuit Court. To this the court said: "Section 55 of the act, in express terms, places the receiver under the direction of the court in taking possession of the property

of the effect to be given an injunction upon a banking corporation and the appointment of a receiver under the statute; and, in connection therewith, and as the material inquiry in the present case, to consider the nature and effect of an attachment or mesne process, and to what extent such attachment constitutes a lien or incumbrance upon the assets of the bank. The power and authority of receivers appointed under the provisions of the statutes referred to are not distinctly defined by this statute, but it is provided in general terms that one of the justices of the court may appoint receivers to take possession of the property and effects of the corporation, subject to such rules and orders as may, from time to time, be prescribed by the Supreme Judicial Court. * * * There is no express provision in the statutes cited dissolving existing attachments upon the transfer of the property of the corporation to receivers similar to that found in the General Insolvent Law; and if such effect follows, it results from general principles governing cases of this nature, rather than by force of any special enactment. * * * We are satisfied that under the laws of Massachusetts an attachment is a lien or incumbrance upon the property attached. It fastens itself upon the property, and whoever takes the property takes it *cum onere*. It is constantly spoken of as a lien in the books of reports, in the arguments of the bar, and in the opinions of the bench. It is not a lien in that sense which requires the party to be in possession of the property thus incumbered or charged with it. An attachment of real estate does not require a change of possession, but that does not make it the less a lien in the sense which we attach to that term. * * * But it is further urged that if such be the rule of law as to the nature and effect of an attachment, yet it is a lien capable of being dissolved, and that by the force and effect of the injunction issued by this court against the Phœnix Bank, and the appointment of receivers to take control and management of the assets of the bank for the benefit of all concerned, the attachment was *ipso facto* dissolved. * * * We think there is a manifest distinction between the case of an attachment before and one made after proceedings instituted praying for an injunction and the appointment of receivers. In the latter case the attachment is ineffectual. The property is in other hands, and beyond the process of an attachment. But in the former case a valid attachment has been made, and, hence, it will bind the property; and although the assets pass into the hands of receivers, they take them with all the liens thereon, and an ex-

and assets of the bank, the collection of claims, compounding of debts, sales of property and the enforcement of the individual liability of stockholders. It is true that the statute fixes the depository of the fund, not with the register of the county, but with the state treasurer, and the distribution is under the direction of the commissioner, but the receiver is nevertheless an officer of the court as much as a receiver appointed in the ordinary way under a bill in chancery. The commissioner of banking does not appoint the receiver. It is done by the court upon the petition of the commissioner approved by the attorney-general; and when the funds are paid into the hands of the receiver, and deposited with the state treasurer, the receiver and not the commissioner makes the ratable dividends. The receiver represents the insolvent bank. Under the statute all claims against it are to be presented to him for allowance, and if he does not allow them the claimant may invoke the aid of the court." [1]

isting attachment is a lien. * * * It seems, therefore, quite clear that there is nothing in the nature of the process by injunction against the Phœnix Bank, and the appointment of receivers which necessarily dissolves an attachment of the assets of the bank previously made. There is nothing in the principle of equal distribution among all creditors *pro rata* which has been considered powerful enough to set aside the priority already acquired by a vigilant creditor. There is nothing in our statutes declaring such previous attachments to be dissolved by force and effect of appointment of receivers.'" The Nebraska court then cited as to the same effect as the Massachusetts case, just referred to, the case of Von Roun *v.* Superior Court, 58 Cal. 358, and Walling *v.* Miller, 108 N. Y. 173; s. c., 15 N. E. Rep. 65. They then said of a Colorado case: "In Breene *v.* Bank, (Col.) 17 Pac. Rep. 280, the Merchants and Mechanics' Bank suspended payment on the afternoon of the 30th of January, 1884. It was then, and had been for some time, insolvent. At the time it closed its doors it was indebted to Breene in the sum of seven thousand dollars, and on that day he brought a suit against the bank to recover the amount due him, and caused an attachment to be issued and levied upon the assets of the bank. Six days later, on application of the stockholders, one Talbot was appointed receiver for the bank. He intervened in the suit brought against the bank by Breene, and filed a notice to dissolve the attachment. The Supreme Court of Colorado held that the creditors of insolvent corporations, as those of other insolvents, have no equitable liens superior to an attachment unless a court of equity lawfully assumes jurisdiction before attachment, and reversed the judgment of the District Court, which had dissolved the attachment on the motion of the receiver."

[1] Citizens' Savings Bank *v.* Person, Circuit Judge, etc., (1893) 98 Mich. 173, 175, 176. The court then said: "It is apparent that the court appointing the receiver has jurisdiction over him and the fund, and may permit any claimant to present his claim in that proceeding, and make his proofs and establish it therein. There can be found in this statute no prohibition upon the court, they having jurisdiction, from proceeding under its general powers to hear and determine the questions arising upon such claims. The claims, under the statute, are not to be presented to the insolvent bank, but to the receiver; and in any action brought to prove such claim against the insolvent bank, the receiver, and not the bank, is necessarily the party interested in contesting it and to insist upon its being properly established by competent evidence. In doing this he is acting as an officer of the court and under its direction. The court, by the appointment of the receiver, has taken into its own hands the subject-matter of the litigation over such claims as may be presented, and holds it pending the proceedings and until the final disposition of all questions, legal and equitable, involved in the action. It would lead to most unseemly struggles if parties having claims against insolvent banks could apply to any other tribunal for such allowance, and thus compel the receiver, who must in all such cases be made the party defendant, to appear in other jurisdictions to defend against the other. To permit the receiver to be sued in any other court upon such claims would not be compatible with the dignity and authority of the court appointing him, and would lead to great inconvenience and cost to the estate which the receiver represents. The proper and orderly manner for the allowance of such claims is by petition to the court appointing the receiver, and in the same action. The practice is for persons having claims against property in the hands of a receiver to intervene in the suit by petition, and have their rights adjudicated. Beach Rec. § 654. The court should grant leave to the petitioner so to intervene and prove his claim, unless it clearly appears that the demand has no legal foundation. The insolvent bank is not the party to be impleaded. The receiver is the only proper party. He has the assets of the bank under his control and is bound to protect the fund for those who are legally entitled to distributive shares. No suit can be brought by or against the receiver without leave of the court appointing him; but that court should in all cases permit the party having the claim to intervene in the proceeding and make proof of it, when he shows a probable cause of action, and in appropriate cases the trial should be upon the law side."

§ 351. For what amount claims should be made and allowed.— An allowance by the comptroller of the currency out of the assets of an insolvent national bank to a creditor who brought suit on his claim and reduced it to judgment, for the amount due on the claim at the date of the failure, and the disallowance by him of the claim as it appeared on the face of the judgment, was approved by the Supreme Court of the United States in a suit for *mandamus* to compel the comptroller to pay a dividend on the amount claimed on the face of the judgment.[1]

[1] White *v.* Knox, (1884) 111 U. S. 784, affirming the refusal of the *mandamus*. WAITE, Ch. J., for the court, said as to the law in such case: "Dividends are to be paid to all creditors ratably, that is to say, proportionally. To be proportionate they must be made by some uniform rule. They are to be paid on all claims against the bank previously proved

It was claimed by a bank here that had made a loan to this insolvent bank and received from it collaterals to secure that loan, that it was entitled to prove its claim for a dividend from the receiver for the full amount of the original loan notwithstanding it had received money upon a portion of the collaterals.

and adjudicated. All creditors are to be treated alike. The claim against the bank, therefore, must neccessarily be made the basis of the apportionment. If the comptroller is satisfied with the proof which is furnished to him, he can allow the claim, and when the allowance is made the creditor becomes entitled at once to participate in all dividends that may be declared. If the comptroller declines to recognize the claim as valid, it must be established by the adjudication of some competent court before it can share in the distribution of assets. When adjudicated in favor of the creditor it is established as a claim against the bank, and must be treated accordingly by the comptroller. The business of the bank must stop when insolvency is declared. Rev. Stat. § 5238. No new debt can be made after that. The only claims the comptroller can recognize in the settlement of the affairs of the bank are those which are shown by proofs satisfactory to him, or by the adjudication of a competent court, to have had their origin in something done before the insolvency. It is clearly his duty, therefore, in paying dividends, to take the value of the claim at that time as the basis of distribution. If interest is added on one claim after that date before the percentage of dividends is calculated, it should be upon all, otherwise the distribution would be according to different rules, and not ratably as the law requires." There was an insistment in this case, on the part of the relator, that he was entitled to dividends on his judgment, as that was the amount adjudicated to him, and the advantage he would get in this way was no more than just, because of the trouble and expense he was put to in carrying on his litigation, and the delay he had suffered in getting his money. To this the chief justice said: "The question here is not whether he should be paid interest on the several items of percentage which make up the aggregate of sixty-five per cent from the time of the payment of dividends to other creditors until his claim was adjudicated, but whether the amount of his judgment must be taken as the sum on which his dividend is to be paid. As has already been seen, the dividends are to be paid on the adjudicated claim, not on the amount due upon the claim when adjudicated. The judgment established the claim as a claim against the bank at the time of the insolvency, and the amount due when the judgment was rendered. Thus the claim was adjudicated, and the amount due at the date of the judgment ascertained; but for the comptroller to pay the relator on the amount due him at that time, and the other creditors on the amount due them eight years before, when the insolvency occurred, would certainly not be making ratable dividends from the assets on all claims against the bank. It was clearly right, therefore, to ascertain from the judgment how much was due on this claim at the date of the insolvency, and make the distribution accordingly. The trouble and expense which the relator has been put to for the establishment of his claim are but incidents to the business in which he was engaged. It was the duty of the comptroller, if not satisfied of the correctness of the claim

The United States Circuit Court for the southern district of Ohio held, however, that Revised Statutes United States, sections 5235, 5236, which provide respectively that the comptroller on appointing a receiver for an insolvent national bank, shall advertise for proof of claims, and that he shall make a ratable dividend of the moneys paid over to him by the receiver among those who have presented their claims, cannot be construed to fix the date of the suspension of the bank as a date with reference to which all calculations of the amount due to creditors are to be made as a basis for dividends. Therefore, where after such suspension, but before the filing of a claim with the receiver, such claim was reduced by collecting from collaterals, it should have been credited with such collections when filed, and the balance then found due used as the basis for ascertaining claimant's dividend.[1]

§ 352. What a claimant may be charged with.— This claimant upon funds of the insolvent national bank in the hands of a receiver, having in its hands collaterals placed with it at the time it made its loan to the bank by the vice-president of the same, there were several rulings necessary by the peculiar circumstances as they appeared in the case. Among the collaterals to secure this loan was a note for $25,000 made by one party and

when presented, to disallow it, and if an attempt was made to obtain its adjudication, to make such defense as in his judgment was proper. No provision is made by law for the payment of the expenses of the claimant in his litigation beyond the taxable costs, and necessarily that loss must fall on him as it does on every one who has the misfortune to be driven to the courts for the judicial determination of his rights."

[1] Chemical National Bank *v.* Armstrong, (1892) 50 Fed. Rep. 798. SAGE, J., distinguished White *v.* KNOX, 111 U. S. 784; s. c., 4 Sup. Ct. Rep. 686, by which the contention of the claimant it was urged was supported, and then said: "In none of the cases decided by the Supreme Court does it appear that any payment on account of the indebtedness of the creditor was made, from the proceeds of collaterals or otherwise, after the suspension of the bank and before the proof of claim. There are two other cases in Pennsylvania, in which the doctrine claimed by counsel for complainant is approved, and the weight of authority is the other way. In Lewis *v.* U. S., 92 U. S. 618; Case *v.* Bank, 100 U. S. 446, and Eastern Township Bank *v.* Vermont Nat. Bank, 22 Fed. Rep. 186, the claim proven was for the entire amount of the principal of the indebtedness as it existed when proved, and at the date of the failure of the bank, for nothing had been realized from collateral, and there had been no partial payments, and the questions as to the time with reference to which the amount due shall be adjusted related exclusively to the payment of interest."

indorsed by a second for the accommodation of the vice-president of the bank. A short time before the maturity of this note and other collaterals, the vice-president of the bank requested that they be not presented for payment, but returned, promising that other collaterals should be substituted for them; all of which was done except that this note was not returned. The insolvent bank did not order back this note, and just afterwards it matured without presentment or notice of dishonor to the indorser, who was the only solvent party to the note. The court held that the claimant national bank, having by its negligence failed to preserve the liability of the indorser, was chargeable with the amount of the note as so much received on its claims. That it was no excuse to the claimant bank that the insolvent bank was not a party to the note, it having received it as a security for a loan to the insolvent bank under circumstances from which it might naturally infer the note to be the property of the insolvent bank. That the objection by the claimant bank that the note was made and indorsed merely for the accommodation of the vice-president, who was not a party to the note, and that consequently the claimant bank could not have recovered thereon if the indorser's liability had been preserved, could not be maintained in view of the fact that the indorser had paid three notes, companions to the one in question, without objection, and of evidence that he was interested with the vice-president in procuring the loan which the note partly secured. That the claimant bank, having refused an offer of the receiver to pay dividends on a fixed sum of money which was about the amount due to it on the loan after deducting collections on collaterals, was not entitled to interest on its dividends on affirmance of the action of the receiver by the court. That on ascertaining the amount on which the bank was entitled to a dividend, money collected on the collaterals after proof of its claim, should not be deducted from the amount proven.[1]

§ 353. Claim of an indorser who paid a note which was not surrendered to him.— In this case a note had been indorsed and discounted at a bank. The bank had placed this note with the clearing house with which it was connected, where it was when the note was about to become due. The indorser paid the amount of this note to the bank which discounted it when it fell

[1] Chemical Nat. Bank *v.* Armstrong, (1892) 50 Fed. Rep. 798.

due, and had a receipt from the cashier for the amount, binding itself to recover the note and return it to the indorser. The bank became insolvent, and a sum in cash largely exceeding the amount paid in by the indorser of this note, which had been placed with the bank's cash, went into the hands of the receiver. The committee of the clearing house having procured a judgment upon this note against the indorser, the latter paid it and brought his action against the receiver of the insolvent bank to recover the money he had paid in to the bank for which this note was to have been surrendered to him. The Circuit Court for the eastern district of Pennsylvania held that the effect of the payment by the indorser to the bank and the giving the receipt by the latter was to establish a fiduciary relation between the parties, and not that of debtor and creditor, entitling the indorser to have the assets in the hands of the receiver applied in payment of the amount he had placed in the bank.[1]

[1] Massey *v.* Fisher, (1894) 62 Fed. Rep. 958. BUTLER, D. J., said: "The money was delivered and received to extinguish the note. Neither party contemplated that the bank might use it for another purpose, leaving the note outstanding, and the plaintiff's liability unextinguished. Such application of it, therefore, would be a violation of duty and a fraud. But the question is not new; it arose and was decided in People *v.* City Bank of Rochester, 96 N. Y. 32. The facts there were substantially like those before us. It is true the check in that case was drawn in terms to pay the note. This, however, is an immaterial difference. It is as plain here, as it was there, that the money was delivered and received to take up the note. In Peak *v.* Ellicott, 30 Kans. 156; s. c., 1 Pac. Rep. 499, the facts were identical with those before us. In each of these cases it was held that the transaction established a fiduciary relation between the parties. * * * The receiver and creditors stand on no higher plane than the bank, and can no more assert that it was the bank's money than the bank could. It is true they are entitled to all the bank's property; but this was not its property. It is not important that the plaintiff's money bore no mark, and cannot be identified. It is sufficient to turn it into the bank's vaults, and find that a sum equal to it (and presumably representing it) continuously remained there until the receiver took it. The modern rules of equity require no more. Knatchbull *v.* Hallett, 13 Ch. Div. 696; National Bank *v.* Insurance Co., 104 U. S. 54; Bank *v.* King, 57 Pa. St. 202; Stoller *v.* Coates, 88 Mo. 514; McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173, 214; People *v.* City Bank of Rochester, 96 N. Y. 32; Bank *v.* Weems, 69 Tex. 489; 6 S. W. Rep. 802; Harrison *v.* Smith, 83 Mo. 210; Beach Eq. Jur. § 285; Fisher *v.* Knight, 61 Fed. Rep. 491; s. c., 9 C. C. A. 582." Bank *v.* Dowd, 38 Fed. Rep. 172, was disregarded. The judge resumed: "There is a class of cases — to which Bank *v.* Beal, 49 Fed. Rep. 606, and Bank *v.* Armstrong, 148 U. S. 50; s. c., 13 Sup. Ct. Rep. 533, belong — in which

§ 354. Debts due savings banks preferred under New York statutes.— The Banking Law of New York provides as follows: "Debts due savings banks from insolvent banks preferred. All the property of any bank or trust company which shall become insolvent, shall, after providing for the payment of its circulating notes, if it has any, be applied by the trustees, assignees, or receiver thereof, in the first place, to the payment in full of any sum or sums of money deposited therewith by any savings bank, but not to an amount exceeding that authorized to be so deposited by the provisions of this chapter, and subject to any other preference provided for in the charter of any such trust company."[1] A national bank in the state of New York becoming insolvent, and being placed in the hands of a receiver, there was a submission of a controversy to the Supreme Court of the state of New York as to whether there should not be a judgment in favor of a savings bank of that state against the receiver for the amount of the deposit it had make with the national bank within the limits of the Banking Law, as a preference against the insolvent bank's assets, under the provisions of the law of New York above referred to. The receiver's contention was that the statute of New York was in conflict with sections 5236 and 5242, United States Revised Statutes, which prohibit preferences between creditors of insolvent national banks, and provide for a *pro rata* dividend of assets among the bank's creditors. The Supreme Court of New York held that national banks were subject to state legislation and were governed thereby except where such legislation was in conflict with the act of congress, or where it tended to destroy the utility of said banks as agents of the United States, or interfered with the purposes of the creation; and that it was only when their state law incapacitated them from discharging their duties to the government that it becomes unconstitutional. They upheld the constitutionality of the state law as to the deposit of moneys by savings banks.[2] The court held that this statute of New York as to

it is held that although the relations of the parties there involved were in the beginning fiduciary, they ceased to be so when the agent commingled the money with its own. These, however, were cases where commercial paper was delivered for collection and credit, and where the collection and credit terminated the agency. The commingling and use of the money were in pursuance of the understanding; and upon this construction of the transaction the decisions rest. The distinction is noticed in Knatchbull *v.* Hallett, 13 Ch. Div. 702."

[1] Laws N. Y. 1892, chap. 689, § 130.

[2] Elmira Savings Bank *v.* Davis, (1893) 73 Hun, 357; s. c., 26 N. Y. Supp. 200. The court referred to and quoted from Waite *v.* Dowley, 94 U. S. 527; National Bank *v.* Commonwealth, 9 Wall. 353, and W. U. Tel. Co. *v.* Massachusetts, 125 U. S. 551, and said: "Applying these principles to the present case, it is difficult to see how the state act interferes with the utility of the national bank as an agent or instrumentality of the general government. No possessory right is given until after the bank, by reason of its insolvency, has ceased to be of any utility as an agent or instrumentality of the government, and after its circulating notes are provided for. The logic of the case in 9 Wallace will uphold the law in question here unless it is in conflict with some provision of the United States statute on the subject."

[1] Elmira Savings Bank *v.* Davis, (1893) 73 Hun, 357; s. c., 26 N. Y. Supp. 200. The court referred to the application of the ordinary doctrine of set-off in case of insolvency against the receiver of a national bank in Scott *v.* Armstrong, 146 U. S. 499, and then said: "In Casey, Receiver, *v.* La Societé de Credit Mobilier, 2 Woods, 77, it was held that the preference of one creditor by a national bank, mentioned in section 5242 of the Revised Statutes, is a preference given to the creditor to secure or pay a pre-existing debt; that when a national bank receives a loan on condition that the lender shall be secured therefor, and security is accordingly given by pledging a part of the assets of the bank, this is not a preference within the meaning of section 5242, although the bank is then in an embarrassed state; that the fact that the assets pledged were changed from time to time as they fell due, and others substituted in their stead, according to the contract between the bank and the pledgee, did not make the pledge of the substituted assets void; that the title of the receiver is the same as that of an assignee in bankruptcy, and is subject to all equities. * * * In the present case it must be presumed that the national bank, when, from time to time it received the deposits from the savings bank, knew of the law which authorized such deposit and provided for the preference. The savings bank was not bound to deposit in that particular bank, nor was the latter bound to receive the deposit. But if the one made and the other received the deposit, it must be assumed that both parties then intended that the security provided for by the statute should, at the proper time, be operative. There was then, in effect, a contract that if the deposit or loan was made, the security should be given. This was a part of the transaction in each case of deposit. It was not a case of a security for a prior indebtedness, but it was a case where, on each occasion, a consideration passed of equal value with the security or right given. In this view, and within the rulings in the cases above referred to, there was not a preference in violation of the provisions of section 5242. By virtue of the state act and the conduct of the parties, the savings bank had at least an equitable lien, which is effective

savings banks' deposits in insolvent banks, giving them a preference over other creditors, was not in conflict with the statutes of the United States providing for no preference among creditors and for a *pro rata* distribution of the assets of insolvent national banks among the creditors presenting claims to the receivers. And a judgment was rendered in favor of the savings bank against the receiver of this national bank for the amount of its deposits.[1] Whether or

not a savings bank, under the statutes of New York, would be entitled to a preference or be bound by the United States statute to take its *pro rata* part of the proceeds of the assets of an insolvent national bank, does not appear to have been yet passed upon by the federal courts. But it will probably be very soon. A suit of a savings bank against a receiver of a national bank instituted in the courts of New York has been removed to the United States Circuit Court for the northern district of that state. There was a motion made in the federal court to remand the case, but the court denied the motion.[1] A motion to remand this suit to the state court from which it had been removed to the federal court on the ground that it was not a suit "arising under the Constitution or laws of the United States" under the act for removal of cases from the state courts, was denied.[2]

within the principles laid down in Scott *v.* Armstrong, and is not antagonistic to the *pro rata* distribution provided for in section 5236. The receiver took, subject to any valid liens or equities. The bank that he represents received the deposits subject to the condition imposed by the state statute, and whether it be said that a trust was impressed or a lien imposed, the statute bound the bank and its assets when they passed to the receiver and interfered with no rights of the government. The principles laid down in the Scott case are quite applicable, and justify the claim of plaintiff to a preference."

[1] Auburn Sav. Bank *v.* Hayes, (1894) 61 Fed. Rep. 911. Cox, D. J., said: "This, it seems to me, is a controversy 'arising under the laws of the United States.' Were it not for the state law the plaintiff would of course be paid ratably with the other creditors. Whether or not the state can legislate in this manner with reference to national banks is a question which the federal courts and not the state courts should decide. To give the state courts sole jurisdiction to determine whether state legislation is in conflict with the National Bank Act would, to say the least, tend to throw the national system into confusion. The doctrine of Tehan *v.* Bank, 39 Fed. Rep. 577, is hardly applicable to the present cause. In the Isham case there was no federal question, because the rule of the common law applicable to that controversy was controlling alike upon the state and United States courts. Here, on the contrary, the construction of a United States statute is involved. The plaintiff may be right as to the interpretation of the statute, but that its construction is involved there can be no doubt. Whatever defense the defendant has depends upon the sections [of the United States Revised Statutes] referred to. The question presented by the motion is not what the construction of these sections should be, but whether the state courts or the United States courts should construe them. I am of the opinion that this power belongs to the United States courts. Sowles *v.* Witters, 43 Fed. Rep. 700; Grant *v.* Bank, 47 Fed. Rep. 673; Walker *v.* Richards, 55 Fed. Rep. 129."

[2] Hot Springs Independent School Dist. No. 10 of Fall River County *v.* First Nat. Bank of Hot Springs, (1894) 61 Fed. Rep. 417. SANBORN, Circuit Judge, said: "This suit is brought to compel the receiver of this insolvent national bank to first pay to the complainant, out of the funds of the bank in his hands, several thousand dollars before he pays any dividend to any creditor, on the ground that this receiver holds this sum of money as a trust fund for the complainant, and not as part of the property of the bank, to be distributed among its creditors. Whatever funds and property this receiver has he has received from this insolvent bank, and he holds them by virtue of the laws of the United States under which he holds his appointment, and in accordance with which he must discharge the trust devolved upon him. In this suit he has interposed a demurrer to the plea of the complainant, and the question now at issue is, what construction shall be placed upon the provisions of the National Banking Law with reference to the distribution of the funds of the insolvent banks by receivers under the admitted facts of this case? I am clearly of the opinion that this case is one arising under the laws of the United States. * * * Sowles *v.* Witters, 43 Fed. Rep. 700; Sowles *v.* Bank, 46 Fed. Rep. 513; San Diego Co. *v.* California Nat. Bank, 52 Fed. Rep. 59."

§ 355. **Claims of municipal corporations for moneys deposited by their officers.**— The treasurer and tax collector of a county in California, without authority of law, deposited county moneys in a bank and received certificates of deposit marked "Special." In an action in equity brought by the county, the bank having become insolvent, it was held in the United States Circuit Court for that district that the title to the moneys did not pass to the bank, although there was no agreement that the identical bills should be returned, and they were mixed with the bank's general fund, and the county was entitled to recover an equal amount from the receiver prior to the payment of the general depositors. Upon the question raised on behalf of the receiver that there was no jurisdiction of the case in an equity court, the plaintiff having his remedy at law, it was held that the county's rights in such case were enforceable only by a bill in equity, there being no priority of contract between it and the bank.[1] The United States Circuit Court for the district of

[1] San Diego County *v.* California Nat. Bank, (1892) 52 Fed. Rep. 59. It was said by the court: "A similar point was raised in the case of National Bank *v.* Insurance Co., 104 U. S. 54. In that case one Dillon was the agent of the insurance company. He kept an account with the bank; the account was entered on the bank books with him as general agent. As agent of the insurance company he collected, and it was his duty to remit, the premiums. In the course of his dealings with the bank he borrowed money on his personal obligations. Finally the bank sought to appropriate his deposits to the payment of this debt. The insurance company filed its bill in equity to recover the amount of those deposits, as equitably belonging to it. The fact that they were premiums received for

Washington denied an injunction upon the motion of a county of that state to forbid the receiver of a national bank paying dividends to creditors pending a suit by the county to recover of the receiver the amount of moneys deposited in the bank on its account by the treasurer of the county. The right to priority over other creditors of the bank was claimed by the county on the ground that the officers of the bank, at the time of accepting the deposit, knew that the money was in the official custody of the treasurer, and, therefore, a trust fund. It was held by the court that under the provisions of United States Revised Statutes (§ 5242), which forbids all preferences among creditors, the county had no priority.[1] Cotemporaneously with this last-referred-

the insurance company was shown. The court said: 'It is objected that the remedy of the complainant below, if any existed, is at law, and not in equity. But the contract created by the dealings in a bank account is between the depositor and the bank alone, without reference to the beneficial ownership of the moneys deposited. No one can sue at law for a breach of that contract except the parties to it. There was no privity created by it, even upon the facts of the present case, as we have found them between the bank and the insurance company. The latter would not have been liable for an overdraft by Dillon, as was decided by this court in National Bank *v.* Insurance Co., 103 U. S. 783; and, conversely, for the balance due from the bank no action at law upon the account could be maintained by the insurance company. But although the relation between the bank and its depositors is that merely of debtor and creditor, and the balance due on the account is only a debt, yet the question is always upon 'To whom in equity does it beneficially belong?' If the money deposited belongs to a third person, and was held by the depositor in a fiduciary capacity, its character is not changed by being placed to his credit in his bank account.' See, also, Bank *v.* Gillespie, 137 U. S. 411; s. c., 11 Sup. Ct. Rep. 118; Bank *v.* Walker, 130 U. S. 267; s. c., 9 Sup. Ct. Rep. 519. In the present case not only did the defendant bank, according to the averments of the bill, have knowledge that the depositors of the moneys in question were, at the time of such deposits, officers of the complainant county, and that the moneys so deposited belonged to the complainant, and were, therefore, held by the officers depositing the same in trust for the county, but the bank is chargeable with notice of the fact that the law of the state made it illegal for those officers to make, or the bank to receive, such deposits. Yarnell *v.* City of Los Angeles, 87 Cal. 603; s. c., 25 Pac. Rep. 767." As to the rule declared in the text, see National Bank *v.* Insurance Co., 104 U. S. 56, 67; Peters *v.* Bain, 133 U. S. 694; s. c., 10 Sup. Ct. Rep. 354.

[1] Spokane County *v.* Clark, (1894) 61 Fed. Rep. 538. The court, as to the law in such cases, said: "Money held by a bank as trustee is not a part of its assets, nor legally subject to claims of its creditors. If the money had been kept intact as a special deposit, or if it were possible to prove that any of the complainant's money or any securities or property acquired by the

to case, the United States Circuit Court for the district of Oregon held adversely to the claim of a county of Oregon in a suit against the receiver of a national bank, and the intervention in the same suit of a city of that state, which sought to have a decree that certain deposits made in the bank by the sheriff of the county and the treasurer of the city to be property of the county and city respectively, and that the receiver hold the same as trustee for these municipalities, and that they have a lien upon all money, choses in action and other property of the bank to the amount of the aggregate of the deposits made by their officials. They were held not to have any preference over other creditors.[1]

bank by investment of money with which it had been mingled came into the receiver's hands, according to principles of equity now firmly established, the rights of this complainant to the relief prayed for would be clear; but there is no averment in the bill of complaint that the money deposited can be traced, nor that the estate which has come into the receiver's hands includes securities or property of the bank acquired since receiving said deposit. It does not appear that any of said money was invested, nor that it was not all paid out to the depositors or creditors before the bank closed its doors. The complainant's argument is based upon an assumption that the bank profited by tortiously converting the money. That the bank could not acquire title to money of the county by its own wrongful act is manifestly true; but where the holder of trust funds has actually expended the same, and become insolvent, a practical difficulty in the way of restoring the money to its owner arises, which can no more be overcome by a court of equity than by any other human agency. That very difficulty confronts the complainant and the court in this case; for it is a fact that, in place of actual money in the bank when it suspended, there was only a legal liability, arising from the conversion and expenditure of the money deposited by the treasurer. The practical difficulty of the case is not diminished in the least by characterizing the conversion as a tort, or by any stronger term, for the fact remains that the money is gone. It cannot be recovered until found. The plaintiff's right in this suit attaches not to specific property to which it has title, but only to a chose in action. The law forbids preferences in the distribution of the estate of an insolvent national bank among its creditors, and makes no exceptions of debts due to municipal, county or state governments, nor in favor of claims arising *ex delicto*." The court refers to National Bank *v.* Insurance Co., 104 U. S. 54; Peters *v.* Bain, 133 U. S. 670; s. c., 10 Sup. Ct. Rep. 354; Frelinghuysen *v.* Nugent, 36 Fed. Rep. 229; Bank *v.* Armstrong, 148 U. S. 50; s. c., 13 Sup. Ct. Rep. 533, as sustaining its holding.

[1] Multnomah County *v.* Oregon Nat. Bank, (1894) 61 Fed. Rep. 912. BELLINGER, D. J., *arguendo*, said: "It is settled that a person may follow and reclaim his property, wrongfully appropriated by another, so long as he can find it. If its form has been changed, he may follow the substantial equivalent of his property in whatever form. The property into which his own has been changed is impressed with a trust in his favor.

§ 356. Claims preferred to those of general creditors — illustrations.— In a late case before the Court of Civil Appeals in Texas, the facts were that plaintiff sent a draft to the bank for collection. The bank collected it and then passed into the hands of a receiver without remitting. The defense of the receiver to the action of the plaintiff was that plaintiff had sent the draft for

But the great weight of authority is against any extension of the rule beyond this. The cases most relied upon by the complainants were those in the Supreme Court of Wisconsin, but since the argument defendant has called my attention to the case of Silk Co. *v.* Flanders, (decided in the Supreme Court of Wisconsin in March of this year) 58 N. W. Rep. 383, which overrules former decisions upon this question, and declares the doctrine that when trust money becomes so mixed up with the trustee's individual fund that it is impossible to trace and identify it as entering into some specific property, the trust ceases; that the court will go as far as it can in thus tracing and following trust money, but when, as a matter of fact, it cannot be traced, the equitable right of the *cestui que trust* to follow it fails. The recent cases of Slater *v.* Oriental Mills, (by the Supreme Court of Rhode Island) 27 Atl. Rep. 443, and Association *v.* Austin, (Supreme Court of Alabama) 13 So. Rep. 908, are to the same effect. The case of Shields *v.* Thomas, (Supreme Court of Mississippi) 14 So. Rep. 84, is similar to the present case in its facts. The sheriff of a county, without authority, deposited in a bank, which shortly afterwards failed, taxes collected by him, the officers of the bank knowing the character of the fund. The cash that came into the hands of the receiver of such bank was less than the amount of such fund, and it did not appear that the fund, or any part of it, came into the receiver's hands, either in its original form or as a part of the mass of the bank's assets. The court refused to make the payment of such fund out of the assets in the receiver's hands, a charge upon such assets precedent to the claims of the other creditors of the bank. These are all recent and well-considered cases, and each of these contains a large number of citations in support of the conclusion reached." The court then referred to the following case against these authorities, to wit: San Diego County *v.* California Nat. Bank, 52 Fed. Rep. 59, in which Ross, J., said: "The ordinary creditors became such voluntarily. They deposited the money with the bank with their eyes open. But the money of the complainant was deposited by its officers and received by the bank, not only without the knowledge of the complainant, but contrary to law. To put the complainant on the same terms with the ordinary creditor is to make the former share in a loss to which it did not voluntarily subject itself, and to give to the latter a share in money which never in equity became the property of the bank. This is certainly not just." BELLINGER, D. J., disapproved of this in these words: "Notwithstanding the respect in which I hold the opinion of Judge Ross, I cannot adopt this view in the face of the cases that hold this other doctrine. The correctness of his conclusions as to the injustice of giving the general creditors of the bank a share in the money which never in equity became the property of the bank, cannot be questioned. But this is not what happens in the case under consideration. It does not appear that the money for distribution in-

collection merely, and without other instructions, and that the relation between plaintiff and the bank with reference to the collection was that of creditor and debtor, and that, therefore, the plaintiff was not entitled to the relief sought. The court held that the bank was his trustee, not his debtor, and that he was entitled to be paid the amount of the collection.[1] A Nebraska bank had been impounded under the state banking laws and was in the hands of a receiver within the jurisdiction of the Supreme Court of the state. The receiver declined to pay a certain claim,

cludes any part of that belonging to the involuntary creditor. If this did appear, the lien of such creditor would attach, and he would have his preference. The fact that the money of such creditor or *cestui que trust* cannot be turned to the fund sought to be charged, is the reason that the preference is refused. If his money has been paid out, or has otherwise disappeared, it would not be just that he should take to the exclusion of the general creditors of the bank, who are in no way responsible for the bank's delinquency, and whose deposits may comprise the entire fund which such creditor seeks to appropriate to his exclusive use. His so-called right of preference, in other words, cannot, in justice, extend to the property of others. The theory of preference does not apply in these cases. There is no preference by reason of an unlawful conversion. The so-called right to be preferred in the case of a wrongful conversion is a right of ownership — a right of property ; a right which lays hold of the property whether in its original or in a substituted form; a right which follows the property so long as it can be ascertained to be the same property, or its product, and only does so because the property to be reached can be ascertained to be the same property, or its product. When the means of ascertainment of the identity of property or proceeds fails, the right fails."

[1] **Hunt** *v.* **Townsend, (Tex. 1894) 26** S. W. Rep. 310. It was said by JAMES, Ch. J., after stating the words of the instruction to the bank: "The testimony discloses, in addition to this, that this bank had previously made similar collections for the plaintiff, and that in no instance was the collection carried to plaintiff's credit, as depositor, by the bank, but the entries were confined to a collection register, and remittances made promptly without further communications. It appears that the proceeds of this collection were not remitted, and became mingled with the general funds of the bank, and that more than the amount thereof was on hand of such funds when the property of the bank passed into the hands of the receiver. It is clear to my mind from the discussion of this subject in Bank *v.* Weems, 69 Tex. 489; s. c., 6 S. W. Rep. 802, that the facts will admit of no other conclusion than the one reached by the district judge. The course of dealing between these parties and the acts of the banks in reference to such transactions, necessarily involved an understanding that the collection should be made and remitted without unreasonable delay. There is nothing from which could be implied an authority for the bank to hold the money, and treat it as a deposit. The amount of this collection was on hand of the general funds of the bank when the receiver took possession, and plaintiff is entitled to receive the same, instead of a *pro rata* with creditors."

and the matter, upon his application to the court for direction, was referred to a referee. This referee found that on a certain date the bank made and delivered to claimant its twelve certificates of deposit of $375 each, aggregating $4,500, due and payable, the first, one month, and the others at intervals of one month each thereafter; all drawing interest at six per centum per annum. That the bank paid the first four of said certificates of deposit on the receipt of same by the bank in the usual course of business, and that claimant was the holder and owner of the remaining eight certificates of deposit, and that the same were due and wholly unpaid. That the certificates of deposit were presented to the bank, or the receiver, at their maturity, and payment demanded and refused for want of funds or from want of an order of court directing payment. That the consideration for the issuance of the certificate of deposit was two certain notes and mortgages of a par value of $5,000, several unsecured small notes of a par value of about $1,000, and a small balance on deposit with the bank. That the sale of these securities was made by the claimant in person and on the faith of the solvency of the bank with which he dealt, through its president. That these certificates of deposit were never entered as a charge or liability of the bank on its books, but of this claimant had no knowledge until long after the issuance thereof, but had reason to believe, and did believe, that such certificates represented a *bona fide* indebtedness of the bank to the owner of such certificates. That at the time the certificates of deposit were issued, claimant had no knowledge of the insolvency of the bank issuing them, but took them in the ordinary course of business, in good faith, relying on the solvency of the bank and the *bona fides* of the whole transaction. His conclusion of law was that the amounts due upon the face of the unpaid certificates of deposit were due with interest to the claimant from the bank, and that the receiver should enter for payment and pay the same as other claims not contested. There were exceptions to the report of the referee, but upon a full consideration of the findings and other evidence commented upon as confirming the propriety and justice of the report of the referee, the Supreme Court overruled the exceptions and confirmed the report.[1] In a case where a Texas bank had been placed in the hands of a receiver, the bank being declared insolvent, the agreed statement

[1] State *v.* Farmers & Drovers' Bank of Battle Creek, (1893) 36 Neb. 675.

of facts showed "that in the course of dealing between the [Texas bank] and a [New York bank] the latter was in the habit of discounting notes for the [former] and of forwarding the same on maturity to the [former] for collection and return, with an understanding that the proceeds of such discount notes should be preserved by the [Texas bank] as the property of the [New York bank] and returned to it as such." One question to be determined by the Supreme Court of Texas was, whether, under the agreement and the course of dealing between the two, the collecting bank was to be decreed the trustee of the funds received by it upon the notes which were paid, and of the renewed obligations which were taken in lieu of those which were not paid. The court, upon this question, said: "We think the facts stated in the agreed statement settle the question of trust in the affirmative. If the securities had been sent for collection merely, the proceeds to be credited to the New York bank, it is clear that after their collection the relation of debtor and creditor would have subsisted, and the latter would have no claim upon the funds. But, by the understanding between the banks and the actual transactions between the parties, as shown by the agreed evidence, a special agency was created, and the [Texas bank] had no authority to hold and credit the proceeds of the notes, but was bound to remit them immediately to its correspondent."[1] As to the claim of the New York bank for full payment of the notes renewed and discounted by it, the court said: "[It] stands upon a very different ground. The agreed evidence shows that the renewed obligations were indorsed by the [Texas bank] and deposited as collaterals with banking houses in the city of New York, and were paid to the holders either in

[1] Continental National Bank of New York *v.* Weems, Receiver, (1888) 69 Tex. 439; s. c., 6 S. W. Rep. 802. The court said: "This principle was clearly recognized by this court in the case of The City Bank of Sherman *v.* Weiss, 67 Tex. 331, and is sustained by the great weight of authority, as appears from the citations in the opinion. But it is insisted by counsel for the [receiver] that there is other evidence in the record not inconsistent with the agreement, which shows that the relation of debtor and creditor and not that of trustee and *cestui que trust* was created by the transaction. We think, however, that any evidence to show this fact in the face of the explicit statement in the admitted proof would be inconsistent with the agreement, and should have been disregarded by the court, whether objected to or not. But we do not regard the evidence relied on as being in conflict with that in the agreed statement."

whole or in part. As to the one which was only partially paid, the agreement recites 'that said renewal note to the amount of twelve hundred and fifty dollars went to pay the draft of said [insolvent bank], and benefited its estate accordingly.' As to the other two, the language in reference to the disposal of the proceeds is a little different, but we presume it means the same thing. We, therefore, deduce from the admitted facts that with the proceeds of the notes now under consideration, obligations of the insolvent bank were discharged, and that no other benefit accrued to its estate. Now, the question is, has the [New York bank] a lien upon the general assets in the hands of the receiver for the proceeds so appropriated? We think not. To hold the affirmative of this proposition would be to declare that every one who receives the money of another in a fiduciary capacity and expends it in the payment of his own debts, thereby creates a lien upon his entire estate in favor of the owner of the money so expended. But this is clearly contrary to the doctrine of constructive trusts. The true rule is that the trust estate must be clearly turned into other specific property in order that the *cestui que trust* may claim either the property itself or a lien upon it. This is the doctrine uniformly applied in the older cases and laid down by the text books upon the law of trusts." [1] In this same case the courts in which the proceedings in insolvency of the Texas bank were had, had charged the New York bank with certain notes sent by the former to the latter to be discounted. The facts in the case were that the Texas bank sent the notes to the New York bank to be discounted and to have the proceeds placed to its credit, according to a previous course of dealing between them. The latter refused to discount the paper, and so notified its correspondent, but before the notice of refusal to discount was received by the latter, not doubting that the paper would be discounted, it drew upon the New York bank to the amount of about $5,000. The New York bank paid the drafts, relying upon the notes for reimbursement. Of the contention that the New

[1] Continental National Bank of New York *v.* Weems, Receiver, (1888) 69 Tex. 489, 498, 499; s. c., 6 S. W. Rep. 802; citing Perry *v.* Phelips, 4 Ves. 107; Lewis *v.* Madocks, 17 Ves. 48; Denton *v.* Davies, 18 Ves. 499; Taylor *v.* Plumer, 3 Maule & S. 562; Pennell *v.* Deffell, 4 De G., M. & G. 372; Knatchbull *v.* Hallett, 13 Ch. Div. 696; Pharis *v.* Leachman, 20 Ala. 662; Noble *v.* Andrews, 37 Conn. 346; Roberts *v.* Broom, 1 Harvey, 57; 2 Perry on Trusts, § 835 *et seq.*; 2 Story's Eq. Jur. § 1258; 2 Pomeroy's Eq. § 1051.

York bank had a lien upon this paper for the payment not only of the $5,000 so paid, but also for its general balance on account against its correspondent, the Texas Supreme Court said: "This proposition cannot be maintained. It is frequently said that a banker has a lien upon the funds in his hands for the indebtedness of his creditors, and it is argued that the rule applies unless there is an agreement to the contrary. But we understand the rule to be that in order to give such lien there must be a contract for that purpose, either express or implied. 'The credit must be given on the credit of the securities or valuables either in possession or expectancy. Russell *v.* Hadduck, 3 Gilm. 233. This is the extent of the banker's lien.' Fourth Nat. Bank *v.* City Nat. Bank, 68 Ill. 398. See, also, Jarvis *v.* Rogers, 15 Mass. 389; Lucas *v.* Dorrien, 7 Taunt. 279. In the case last cited, a bond was presented to a banker by his customer as collateral for a loan, which the banker declined to accept, and it was casually left with him. It was held that he had no lien upon it. So, in this case, the [New York bank] having refused the paper, had no right to hold it, and should have returned it. Having failed to do so it has no lien except for the amount of the drafts paid after the paper was received." [1] An Ohio national bank entered into a contract with a Pennsylvania bank to do the collection business of the latter in western cities, by itself or through its agents, and to allow a percentum upon daily balances, and to remit on the first, eleventh and twenty-first of each month. The Pennsylvania bank stamped upon its paper forwarded for collection, "Pay to" the Ohio bank "or order for collection per" the Pennsylvania bank. The Ohio bank became insolvent and was placed in the hands of a receiver. Collections had been made on paper of the Pennsylvania bank and the latter brought its action against the receiver to recover, as special funds belonging to it at the time of the insolvency of the Ohio bank, the various amounts collected on its paper forwarded for collection. There was an appeal from the United States Circuit Court to the Supreme Court of the United States. The United States Supreme Court

[1] Continental National Bank of New York *v.* Weems, Receiver, (1888) 69 Tex. 489, 501; s. c., 6 S. W. Rep. 802, where the court stated that the proper judgment would have been to charge the New York bank in the account with the moneys collected upon the paper, and with the value of so much of it as remained unpaid, to be set off by the amount of the drafts drawn upon it by the Texas bank after the notes were forwarded for discount.

held that the Pennsylvania bank was entitled to have the amounts collected by the sub-agents of the Ohio bank and paid by them to the receiver of the latter, paid to it out of the assets in his hands.[1] As to those moneys collected by the sub-agents to which the Ohio bank was in debt, and which collections had been credited by the

[1] Commercial Bank of Pennsylvania *v.* Armstrong, (1893) 148 U. S. 50. Mr. Justice BREWER, speaking for the court, said: "We agree with the circuit judge, that the relation created between the banks as to uncollected paper was that of principal and agent, and that the mere fact that a sub-agent of the [Ohio] bank had collected the money due on such paper, was not a mingling of those collections with the general fund of the [Ohio bank], and did not operate to relieve them from the trust obligation created by the agency of the [Ohio bank], or create any difficulty in specially tracing them. As to such paper, the transaction may be described thus: The plaintiff handed it to the [Ohio bank], the [latter] handed it to a sub-agent, the agent collected it, and held the specific money in hand to be delivered to the [Ohio bank]; then the failure of the [latter] came, and the specific money was handed to its receiver. That money never became a part of the general fund of the [Ohio bank]; it was not applied by the sub-agent to reducing the indebtedness of the [Ohio bank] to it, but it was held as a sum collected to be paid over to the [latter], or to whomsoever might be entitled to it. The [Ohio bank] received the paper as agent, and the indorsement 'for collection' was notice that its possession was that of agent and not of owner. In Sweeny *v.* Easter, 1 Wall, 166, 173, in which there was an indorsement 'for collection,' Mr. Justice MILLER said: 'The words 'for collection' evidently had a meaning. That meaning was intended to limit the effect which would have been given to the indorsement without them, and warned the party that, contrary to the purpose of a general or blank indorsement, this was not intended to transfer the ownership of the note or its proceeds.' And in White *v.* National Bank, 102 U. S. 658, 661, where the indorsement was 'for account,' the same justice, speaking of the indorsement, said: 'It does not purport to transfer the title of the paper, or the ownership of the money when received.' The plaintiff, then, as principal, could unquestionably have controlled the paper at any time before its payment, and this control extended to such time as the money was received by its agent, the [Ohio bank]. Butchers', etc., Bank *v.* Hubbell, 117 N. Y. 384; Manufacturers' Bank *v.* Continental Bank, 148 Mass. 553; Freeman's Bank *v.* National Tube Works, 151 Mass. 413; Armstrong *v.* National Bank of Boyertown, (Ky.) 14 S. W. Rep. 411; Crown Point National Bank *v.* Richmond National Bank, 76 Ind. 561. In those cases the suits were against sub-agent banks. It is true that in most of them the collection was made by the sub-agent after the avowed insolvency of the agent, but that fact, we cannot think, is decisive. If, before the sub-agent parts with the money or credits it upon an indebtedness of the agent bank to it, the insolvency of the latter is disclosed, it ought not to place the funds which it has collected, and which it knows belong to a third party, in the hands of that insolvent agent or its assignee; and, on the other hand, such insolvent agent has no equity in claiming that this money, which it has not yet received, and which belongs to its principal, should be transferred to

sub-agents upon the debts of the Ohio bank to them before its insolvency was disclosed, the court held that the moneys had practically passed into the hands of the Ohio bank, and the collection had been fully completed; that it was the same as though the money had actually reached the vaults of the latter; and, so far as these moneys were concerned, there was no trust attached to them; the Ohio bank was, as to them, simply a debtor to the Pennsylvania bank.[7] In a Nebraska case for the foreclosure of a

and mixed with its general funds in the hands of its assignee, for the benefit of its general creditors, and to the exclusion of the principal for whom it was collected. Whether it be said that such funds are specifically traceable in the possession of the sub-agent, or that the agent has never reduced those funds to possession, or put itself in a position where it could rightfully claim that it has changed the relation of agent to that of debtor, the result is the same. The [Ohio bank] received this paper as agent. At the time of its insolvency, when its right to continue in business ceased, it had not fully performed its duties as agent and collector; it had not received the moneys collected by its sub-agent. They were traceable as separate and specific funds, and, therefore, the plaintiff was entitled to have them paid out of the assets in the hands of the receiver, for when he collected them from these sub-agents he was in fact collecting them as the agent of the principal. No mere bookkeeping between the [Ohio bank] and its sub-agent could change the actual status of the parties, or destroy rights which arise out of the real facts of the transaction."

[7] Commercial Bank of Pennsylvania *v.* Armstrong, (1893) 148 U. S. 50. Mr. Justice BREWER said: "The conclusions of the Circuit Court [upon this branch of the case] were based upon the idea that these collections could not be traced, because they had passed into the general fund of the bank. We think, however, a more satisfactory reason is found in the fact that, by the terms of the arrangement between the plaintiff and the [Ohio bank], the relation of debtor and creditor was created when the collections were fully made. The agreement was to collect at par, and remit the first, eleventh, and twenty-first of each month. Collections intermediate these dates were, by the custom of banks and the evident understanding of the parties, to be mingled with the general funds of the [Ohio bank] and used in its business. The fact that the intervals between the dates and remitting were brief is immaterial. The principle is the same as if the [Ohio bank] was to remit only once every six months. It was the contemplation of the parties, and must be so adjudged according to the ordinary custom of banking, that these collections were not to be placed on special deposit and held until the day of remitting. The very fact that collections were to be made at par shows that the compensation for the trouble and expense of collection was understood to be the temporary deposit of the funds thus collected, and the temporary use thereof by the [Ohio bank]. The case of Marine Bank *v.* Fulton Bank, 2 Wall. 252, is in point, though it may be conceded that the facts in that, tending to show the relation of debtor and creditor, are more significant than those here. In the spring of 1861, the Fulton Bank of New York sent two notes for collection to the

mortgage upon real estate of a husband and wife, it appeared that the husband was president of a bank to which the owner of certain notes and mortgages had sent directly with instructions to collect the amounts due in each instance, and remit to him, etc. The bank did collect and remit, as instructed, the most of the notes and mortgages. The president of the bank collected himself the amounts due on the others, and not remitting, afterwards, with his wife, executed the mortgages involved in this action to secure the amounts to the plaintiff, who was the owner of the notes and mortgages. The bank being insolvent had passed into the hands of a receiver, and it was claimed before the court that the mortgages were to secure the debt of the president to the bank for the moneys collected, and that the moneys realized out of these mortgages should go into the general funds of the bank in the hands of the receiver, and that there should be no preference of this creditor as to that fund. It was found by the trial court that the

Marine Bank of Chicago; there being some trouble about currency, the Fulton Bank requested the Marine Bank to hold the avails of the collection subject to order, and advise amount credited. Afterwards the Marine Bank sought to pay in the currency which it had received on the collection, then largely depreciated, but its claim in this respect was denied, Mr. Justice MILLER, speaking for the court, saying: 'The truth, undoubtedly, is * * * that both parties understood that when the money was collected plaintiff was to have credit with the defendant for the amount of the collection, and that defendant would use the money in its business. Thus the defendant was guilty of no wrong in using the money because it had become its owner. It was used by the bank in the same manner that it used the money deposited with it that day by its city customers; and the relation between the two banks was the same as that between the Chicago bank and its city depositors. It would be a waste of argument to attempt to prove that this was a debtor and creditor relation. All deposits made with bankers may be divided into two classes, namely, those in which the bank becomes bailee of the depositor, the title to the thing deposited remaining with the latter; and that other kind of deposit of money peculiar to banking business in which the depositor, for his own convenience, parts with the title to his money and loans it to the banker, and the latter, in consideration of the loan of the money and the right to use it for his own profit, agrees to refund the same amount or any part thereof on demand. The case before us is not of the former class. It must be of the latter.' That reasoning is applicable here. Bearing in mind the custom of banks, it cannot be that the parties understood that the collections made by the [Ohio bank] during the interval between the days of remitting were to be made special deposits, but, on the contrary, it is clear that they intended that the moneys thus received should pass into the general funds of the bank and be used by it as other funds, and that when the day for remitting came the remittance should be made out of such general funds."

sum claimed, the amount of plaintiff's notes collected, was due to him, and that he was entitled to a foreclosure against certain of the lots of land mortgaged; and that, as to those lots, the mortgage gave a lien to the plaintiff for the amount of the mortgage thereon, and that the execution of such mortgage did not confer or pass any right or title to said lots to the receiver of the bank. The Supreme Court affirmed the judgment upon these findings.[1]

§ 357. Claims not preferred to those of general creditors — illustrations.— The owner of a note executed by a depositor in a Michigan bank sent the same to the bank for collection. At the time it fell due the maker having to his credit in the bank, as appeared on its books, more than sufficient to meet the note, gave his check for the amount, and the note was delivered to him by the bank. Within ten days afterwards the bank's insolvency was declared, and its affairs placed in the hands of a receiver. It appeared that there was not, at the time the check of the maker of the note was drawn, cash to any amount in the bank, it being then in an insolvent condition, and the receiver had placed

[1] Griffin *v.* Chase, (1893) 36 Neb. 328. The reasoning and statement of law involving the rights of the parties in the case were as follows: "We think that the proof establishes the fact that the bank received the money in question of the plaintiff, as his agent, with directions to remit to him. The money was not to be deposited in the bank but sent at once. This simplifies the case very much. It is very clear that the bank was the agent of the plaintiff, and that the relation of principal and agent existed between them. The bank, therefore, held the funds of the plaintiff as trust funds, and they were never mingled with the funds of the bank with the plaintiff's consent. In Peak *v.* Ellicott, 30 Kans. 156, where a party had paid to the receiver of a bank the amount of a note given by him to the bank, which the cashier claimed had been re-discounted in another town, but would be sent for and canceled, the bank soon afterwards failed without canceling the note. The court held that the money so received was a trust fund which must be applied to the purposes indicated, and that it did not become a part of the assets of the bank. To the same effect, Ellicott *v.* Barnes, 31 Kans. 170. In McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173, it was held that a banker who accepts for collection a draft and, in fact, collects the money thereon, holds the same as trustee of the owner; and, after his assignment for the benefit of creditors, the trust character still adheres to the funds in the hands of the assignee irrespective of other creditors. Francis *v.* Evans, 69 Wis. 115; s. c., 33 N. W. Rep. 93; Anheuser-Busch Brewing Assn. *v.* Morris, 36 Neb. 31. Other cases to the same effect can readily be cited, but it is unnecessary. That the moneys were held in trust there is no doubt, and as such they did not belong to the bank or become a part of its assets."

in his hands but a nominal sum in cash. The owner of the note petitioned the court appointing and controlling this receiver to order him to pay the amount which was apparently collected for him by the bank. He insisted that the acceptance of the check by the cashier in payment of the note, as stated, was the same in effect as though the money had been actually paid into his hands by the maker of the same, and by the cashier put into the funds of the bank for the benefit of the general creditors, or traced into the hands of the receiver, thus giving the petitioner the right to claim that in equity the amount of money claimed should be considered as a trust fund in the hands of the receiver, which should be paid to the petitioner by him in full, and without regard to the claims of the other creditors of the bank. The contention on behalf of the receiver was that the relation of trustee and *cestui que trust* as to this amount did not exist, based upon the fact that there was no payment of money for the note by the maker of the same; that, as a matter of fact, in consequence of the insolvent condition of the bank on the day he gave his check in payment of the note he had no money on deposit, but only a credit on account of the deposits which he had made at different times before that date. The prayer of the petitioner was denied, and the Supreme Court of Michigan affirmed this judgment on the appeal.[1] Here two banks for several years had

[1] Sherwood *v.* Milford State Bank, (1892) 94 Mich. 78. The opinion of the court in the matter was thus expressed: "If the bank had been paid the money for the note, or if, having taken the check as it did, it had taken the money which it represented, and in either case converted it into any other fund or other assets, and it could have been traced into the hands of the receiver by the petitioners, their right to the order asked for would be clear under the general rule that, when property held upon trust to keep, use, disburse or invest in any particular manner is misapplied by the trustee, and converted into different property or sold, and the proceeds thus misapplied, the property may be followed wherever it can be traced through its transformations, and will be subject when found in its new form to the rights of the original owner or *cestui que trust.* Cook *v.* Tullis, 18 Wall. 341; Neely *v.* Rood, 54 Mich. 134; Pierce *v.* Holzer, 65 Mich. 263. But in all these cases it is held that the fund must be clearly traced into the hands of the person sought to be charged, and that if the trust property does not remain, but has been made way with by the trustee, *cestuis que trustent* have no longer any specific remedy against any part of his estate in his insolvency, but they must come in *pari passu* with the other creditors, and prove against the trustee's estate for the amount due them. This rule has been as steadily adhered to by the courts, both of this country and of England, as any rule which has ever been adopted for the protection of the general creditors of a bankrupt or of an insolvent. It is not seriously contended that the claim of the petitioners comes within the rule stated, but it is insisted that they have the right to the order asked for, under the principle asserted in Carley *v.* Graves, 85 Mich. 483, in which Chief Justice Champlin said, in relation to the trust fund then under consideration, that 'it cannot be specifically traced, but there is enough in the proof to warrant the inference that it has mingled the trust fund with its own individual means, and has rendered it impossible to be specifically traced into other property in its hands, and that it has been used by the company either to pay off its debts or to increase its assets; in either case it would be to the benefit of its estate,' and under those facts he applied the principle laid down by a divided court in McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173, in support of the position, and held that the petitioner was entitled to the order." Commenting upon this expression of law by the chief justice, it was said: "Without discussing the extent to which the language used in that case would seem to imply a departure from, or rather an enlargement of, the general rule first stated, it is sufficient to say that no such condition exists here. There was no appropriation of the proceeds of the check; no mingling of the money realized from it with the assets of the bank for its own benefit, as there was no money realized from it, nor any use made of it by the bank, either to pay off its debts or to increase its assets. For these reasons no possible benefit could accrue to the general creditors of the bank on account of the transaction referred to. To adopt a rule which would permit the petitioners, under the facts of this case, to impose upon this transaction the character of a trust, enforceable as such against the receiver, without either tracing any of its results into his hands, or showing that it was for the benefit of those who have an interest in the assets, thus enabling them, with others similarly situated, to convert to the payment of their own debt the assets of the bank, to the exclusion of the general depositors, whose money, as it is plain to be seen from the record, was the source from which all the assets of the bank were obtained, would be grossly inequitable and would be an unwise departure from those safe rules which the courts have adopted and very generally adhered to in relation to the rights and obligations existing between trustees and *cestuis que trustent.*"

acted as agents for each other in the collection of checks, notes and drafts, the practice being for each to credit the other for checks when received, and for drafts and notes when advised of their payment. When a check was returned unpaid, after being credited, the amount thereof was charged back again. The amounts thus collected were mingled with the general funds of the bank. The plaintiff bank sent to the bank of which defendant had been appointed receiver, the bank becoming insolvent, a note for "collection and credit," which, on maturity, was paid by a check, and credit was immediately given on the books. The collecting bank failing, the check passed into the hands of the receiver. In this action against the receiver to recover this check

or its proceeds, it was held by a federal court that, in view of the course of dealing, the two banks stood in the relation of debtor and creditor with respect to the amount of the check, and that it became a part of the assets of the insolvent bank.[1] The United States Circuit Court for the northern district of Alabama has held that a bank which collected a draft sent to it by another bank for collection, with directions to remit the proceeds to a third bank for the owner's account, did not thereby become a trustee, so that the fund could be followed into the hands of a receiver, although it had become mixed with the other cash of the bank before his appointment, especially where it appeared that the business was carried on and money paid out for several days after the collection was properly made.[2] In a case where a corporation had sent to a bank for collection a draft on one of its debtors, which he paid by a check on the bank, and the bank remitted in payment a check upon which in the end the corporation failed to realize its money, the bank, by its owner in the meantime, having made an assignment, the corporation procured an order from the court that the assignee of the insolvent banker show cause why its claim should not be declared preferred to that of other creditors. On the hearing the court decided it preferred. Upon appeal to the Supreme Court of Wisconsin, a majority of the court reversed the judgment of the court below, and held that the claim was not a preferred one.[3] A receiver for a bank had been appointed in accordance with the prayer of

[1] Franklin County Nat. Bank *v.* Beal, Receiver, (1892) 49 Fed. Rep. 606. Cf., Marine Bank *v.* Fulton Bank, 2 Wall. 252; Manufacturers' Nat. Bank *v.* Continental Bank, 148 Mass. 555; s. c., 20 N. E. Rep. 193; Levi *v.* Bank, 5 Dill. 104.

[2] Merchants & Farmers' Bank *v.* Austin, (1891) 48 Fed. Rep. 25. See, on this rule, Case *v.* Beauregard, 1 Woods, 126; Union National Bank of Chicago *v.* Goetz, 138 Ill. 127; s. c., 27 N. E. Rep. 907; Peters *v.* Bain, 133 U. S. 693; s. c., 10 Sup. Ct. Rep. 361; McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173; National Bank *v.* Insurance Co., 104 U. S. 54; Bank *v.* Armstrong, 42 Fed. Rep. 193; Bank *v.* Dowd, 38 Fed. Rep. 172; Railroad Co. *v.* Johnston, 133 U. S. 577; s. c., 10 Sup. Ct. Rep. 393.

[3] Nonotuck Silk Co. *v.* Flanders, (Wis. 1894) 58 N. W. Rep. 383. Cassoday, J., speaking for the majority, said: "If plaintiff [was] entitled to such preference at all it must be by virtue of some established principle of equity or the common law," and proceeded to discuss the question in these words: "The early English cases only went to the extent of holding, in effect, that the owner of property intrusted to an agent, factor, bailee or other trustee could follow and retake his property from the possession of such trustee, or others in privity with him, and not a *bona fide* purchaser for value, whether such property remained

a bill filed in equity by some of its creditors. A corporation had forwarded to the bank a draft for "collection and returns." The bank had accepted a check of the drawee, one of its depositors, and, without separating the amount from the general mass of its moneys, charged the same to the drawee, and credited the drawer on its books. The corporation which had sent the draft, and been, as above stated, credited with the amount, intervened in the suit, and asked that the receiver be ordered to pay the amount of its claim. The contention of the claimant was that in the collec-

in its original form, or in some different or substituted form, so long as it could be ascertained to be the same property, or the product or proceeds thereof, but that such right ceased when the means of ascertainment failed, or when the subject of the trust was money, or had been converted into money, and then mixed and confounded in a general mass of money of the same description, so as to be no longer divisible or distinguishable. This is apparent from the opinion of Lord Ellenborough, Ch. J., written nearly 80 years ago, reviewing the adjudications prior to that date. Taylor *v.* Plumer, 3 Maule & S. 575. But the more recent rule in England as to following trust moneys is broader, and goes to the extent of holding, in effect, that 'if money held by a person in a fiduciary character, though not as trustee, has been paid by him to his account at his bankers, the person for whom he held the money can follow it and has a charge on the balance in the banker's hands;' that 'if a person who holds money as a trustee, or in a fiduciary character, pays it to his account at his banker's, and mixes it with his own money, and afterwards draws out sums by checks in the ordinary manner, * * * the drawer must be taken to have drawn out his own money in preference to the trust money.' In re Hallett's Estate (Knatchbull *v.* Hallett), 13 Ch. Div. 696, overruling some former English cases. 'In that case there was no dispute but what the money received by the trustee for the property wrongfully converted was deposited with his bankers to the credit of his account, and that the same remained at his bankers' mixed with his own money at the time of his death.' But in the leading opinion by Jessel, M. R., in that case, and by way of quoting Mr. Justice Fry approvingly, it is said: 'The guiding principle is that a trustee cannot assert a title of his own to trust property. If he destroys a trust fund by dissipating it altogether, there remains nothing to be the subject of the trust. But so long as the trust property can be traced and followed into other property into which it has been converted, that remains subject to the trust. Ibid. p. 719.' That case is as favorable to the claim of the plaintiff as any in the English courts, and yet it nowhere questions the proposition that the owner of the property or money intrusted is entitled to a preference over other creditors of an insolvent estate out of property or assets to which no part of the trust fund, or the proceeds thereof, is traceable. All such cases turn upon the question of fact whether the trust property or fund, or the proceeds thereof, are traceable into any specific property or fund. Ex parte Hardcastle (In re Mawson), 44 Law T. 524. Thus, in Re Cavin *v.* Gleason, 105 N. Y. 256; s. c., 11 N. E. Rep. 504, it was held that, to entitle the trust creditor to such a preference, it must, at least, be made to

tion of its draft on its debtor the insolvent bank had acted as its agent and trustee, and that it was entitled, as against the other creditors of the bank, to priority of payment out of the bank's assets; that, notwithstanding the money collected from its debtor was intermingled with the general assets of the bank, and could not be identified or specifically traced into the hands of the receiver, yet a court of equity would subtract the amount due claimant from the funds in the hands of the receiver, and would

appear that the fund or property of the insolvent, remaining for distribution, includes proceeds of the trust estate." To the same effect, Atkinson *v.* Printing Co., 114 N. Y. 168; s. c., 21 N. E. Rep. 178; Holmes *v.* Gilman, 138 N. Y. 376; s. c., 34 N. E. Rep. 205. In Little *v.* Chadwick, 151 Mass. 110; s. c., 23 N. E. Rep. 1005, the court said: "When trust money becomes so mixed up with the trustee's individual funds that it is impossible to trace and identify it as entering into some specific property, the trust ceases. The court will go as far as it can in thus tracing and following trust money; but when, as a matter of fact, it cannot be traced, the equitable right of the *cestui que trust* to follow it fails." The Michigan court cited as to the same effect as the Massachusetts and other cases above referred to: Goodell *v.* Buck, 67 Me. 514; Steamboat Co. *v.* Locke, 73 Me. 370; Englar *v.* Offutt, 70 Md. 78; s. c., 16 Atl. Rep. 497; Thompson's Appeal, 22 Pa. St. 16; Columbian Bank's Estate, 147 Pa. St. 440; s. c., 23 Atl. Rep. 625, 626, 628; Appeal of Hopkins, (Pa.) 9 Atl. Rep. 867; Bank *v.* Goetz, 138 Ill. 127; s. c., 27 N. E. Rep. 907; Neely *v.* Rood, 54 Mich. 134; s. c., 19 N. W. Rep. 920; Sherwood *v.* Bank, 94 Mich. 78; s. c., 53 N. W. Rep. 923; Elevator Co. *v.* Clark, (N. D.) 53 N. W. Rep. 175; National Bank *v.* Insurance Co., 104 U. S. 54, 68; Peters *v.* Bain, 133 U. S. 670, 693; s. c., 10 Sup. Ct. Rep. 354; 2 Story Eq. Jur. §§ 1258, 1259; 2 Pom. Eq. Jur. § 1058; 1 Lewin Trusts (1st Am. ed.), 241. "In speaking of following trust moneys into other property, it is stated in one of the New York cases cited that 'the right has its basis in the right of property.' It never was based upon the theory of preference by reason of an unlawful conversion. This is made clear by a recent and well-considered opinion by the Supreme Court of Rhode Island. Slater v. Oriental Mills, (R. I.) 27 Atl. Rep. 443. It follows that the mere fact that [the insolvent's] bank used the plaintiff's money towards paying its indebtedness, before making the assignment, did not authorize a preference to the plaintiff over [the assignor's] other creditors, out of his other property and assets. This is made plain by an illustration having judicial sanction in the case last cited: 'Suppose that an insolvent debtor, D., has only $1,000 of property, but is indebted to the amount of $2,000, one-half of which is due to A., and the other half to B. In this condition of things, D.'s property can only pay fifty per cent of his debts. By such distribution A. and B. would each be equitably entitled to $500. Now, suppose D., while in that condition, collects $1,000 for F., but, instead of remitting the money, as he should, he uses it in paying his debt in full to A. By so doing D. has not increased his assets a penny, nor decreased his aggregate indebtedness a penny. The only difference is that he now owes

compel him to restore it to the claimant, because the amount had been collected by the bank as its agent and trustee, and had increased *pro tanto* its general assets. The United States Circuit Court of Appeals for the fifth circuit held that the money was held by the insolvent bank as the agent of the claimant, and not as trustee; and that after the bank became insolvent the claimant was a mere general creditor, and not entitled to priority of payment out of the bank's assets.[1] The Constitution of the state of Alabama provides that "depositors who have not stipulated for interest shall for such deposits be entitled, in case of insolvency,

$1,000 each to B. and F., whereas he previously owed $1,000 each to A. and B. Now if F. is to have preference over B. then his claim will absorb the entire amount of D.'s property, leaving nothing whatever for B. In other words, the $500 to which B. was equitably entitled from his insolvent debtor, upon a fair distribution of the estate, has, without any fault of his, been paid to another, merely in consequence of the wrongful act of the debtor.' Ibid. and dissenting opinion in Francis *v.* Evans, 69 Wis. 115, 123. See, also, McClure *v.* Board, (Col.) 34 Pac. Rep. 763. We must hold that the plaintiff has no rights to a preference over [the banker's] other creditors in the distribution of his estate in the hands of the defendant, as assignee, and into which no part of the plaintiff's money has been issued." The majority of the court said that "in so far as McLeod *v.* Evans, 66 Wis. 401; s. c., 28 N. W. Rep. 173, 214; Francis *v.* Evans, 69 Wis. 115; s. c., 33 N. W. Rep. 93; and Bowers *v.* Evans, 71 Wis. 133; s. c., 36 N. W. Rep. 629, are in conflict with the rules above indicated, they must be regarded as overruled." These cases, ORTON, Ch. J., dissenting, said, ruled this case.

[1] Anheuser-Busch Brewing Assn. *v.* Clayton, (1893) 56 Fed. Rep. 759. TOULMIN, D. J., in the opinion delivered, said: "The relation between [the claimant] and [the insolvent bank] as to the draft on [its debtor] sent by the former to the latter for collection was that of principal and agent; but, in order to enforce a trust in favor of [the claimant] as to any money collected on said draft, it must be specifically traceable into the hands of the receiver. Commercial Nat. Bank *v.* Armstrong, 39 Fed. Rep. 684; same case in Supreme Court of the United States, 148 U. S. 50; 13 Sup. Ct. Rep. 533. Accepting [the drawer's] check in payment of his debt to [the claimant], and charging the amount of it on [the drawer's] account by the bank, was but a shifting of its liability, whereby it became [the claimant's] debtor and assumed the obligation to pay it the amount of the check less exchange. There is nothing to indicate that this amount was separated and kept unmingled with the bank's own money; but, on the contrary, it is conceded that it is undistinguishable from the mass of the bank's own money and cannot be turned to and identified in the hands of the receiver. This being so [the claimant] has no better equity than the other creditors of the bank, and is entitled to no priority over them." See, in line with the text, Maury *v.* Mason, 8 Port. (Ala.) 236; Goldsmith *v.* Stetson, 30 Ala. 164; Parker *v.* Jones, 67 Ala. 236; Illinois Trust & Savings Bank *v.* First Nat. Bank, 15 Fed. Rep. 858; Bank *v.* Dowd, 38 Fed. Rep. 172; Bank *v.* Rus-

to preference of payment over all other creditors." Another contention of claimant in this case was that under this provision of the Constitution of Alabama it at least had a right to be classed among depositors who had not stipulated for interest on deposits, and, therefore, entitled as among that class to be preferred to the other creditors. The Court of Appeals held adversely to this contention.[1] These facts appeared in a case before the Supreme Court of Minnesota: A firm deposited with a bank a check for collection. The bank sent it to the clearing house, where it was used in balancing the account of the bank. Afterwards, on the same day, the bank made an assignment for the benefit of its creditors, but neither the check nor the direct proceeds of the check came to the assignee. In the proceedings in insolvency the lower court, upon an application of the firm depositing the check with the bank, ordered the assignee of the bank to pay to the firm the amount called for by the check. The Supreme Court reversed this order, holding that the depositors

sell, 2 Dill. 215; First Nat. Bank *v.* Armstrong, 42 Fed. Rep. 193.

[1] Anheuser-Busch Brewing Assn. *v.* Clayton, (1893) 56 Fed. Rep. 759. TOULMIN, D. J., said upon this contention: "A bank depositor is one who delivers to or leaves with a bank money subject to his order. And. Law Dict. 343, 344; Newmark Bank Deposits, § 12. Deposits made with bankers are either general or special. In the case of a special deposit of money the bank merely assumes the charge or control of it, without authority to use it, and the depositor is entitled to receive back the identical money deposited. 1 Morse Banks, § 183. The relation thus created is that of bailor and bailee. Money received by a bank on general deposit becomes the property of the bank and can be used by it as other moneys belonging to it, the relation between the bank and the depositor being that of debtor and creditor; 'that kind of deposit of money peculiar to banking business, in which the depositor, for his own convenience, parts with the title to his money and loans it to the banker.' Commercial Nat. Bank *v.* Armstrong, 39 Fed. Rep. 684; Wray *v.* Insurance Co., 34 Ala. 58; Alston *v.* State, 92 Ala. 124; s. c., 9 So. Rep. 732. The contention of the learned counsel for [the claimant] is that his case meets this definition of a general depositor. We cannot agree with this contention. [Claimant] did not leave [its] money with [the insolvent bank] subject to its order or to be returned to it on call. It did not for its own convenience part with the title to its money and loan it to the bank. There was no contract, express or implied, that the collection from [its debtor] on [claimant's] account was to be a deposit of any kind, but it is clear that it was intended that the money received from [the debtor] should be remitted in 'a reasonable time' from date of collection. [Claimant] inclosed its draft on [the debtor] to the [bank] for 'collection and returns.' [The debtor] took up the draft with his check on [the bank], and on the same day the latter forwarded to [claimant] exchange on a New York bank for the amount of [the debtor's]

of the check were not entitled to any preference over other claims against the insolvent.[1] A national bank having been notified by the comptroller that its capital was impaired, it was agreed that it might continue business on the directors putting in $100,000 in cash, and retiring that amount of objectionable securities. The directors contributed the sum required in cash, an account being opened with trustees appointed by the directors to manage the fund, with full power, as far as the bank was concerned, and to account therefor to the contributors in such manner as to protect the equities of each individual and the bank, in relation to the bank and its legal rights. It was understood between the trustees and the bank examiner that the securities to be retired were to be designated by the comptroller or examiner, but there was no such understanding with the comptroller. The full amount of objectionable securities had not been selected and given to the trustees when the bank was closed, the receiver taking and proceeding to collect the whole assets. It was claimed by the trustees for the directors that the balance was held by the bank as a special or trust fund; that it did not form part of the assets of the bank; that the receiver was chargeable with notice of the nature of the fund; and that when the receiver was placed in control of the bank this balance came into his hands impressed with the trust originally pertaining thereto; and that he must account therefor for the use of the directors. SHIRAS, J., of the United States Circuit Court, held, however, that the receiver was not required to account for the balance of the $100,000 as a special trust fund, but merely as a debt.[2]

indebtedness. The draft was not paid, but this did not alter the relation between [the claimant] and [the bank]. The bank still owes the debt."

[1] In re Seven Corners' Bank, (Minn. 1894) 59 N. W. Rep. 633, GILFILLAN, Ch. J., said: "The case is not essentially different from what it would have been had the bank received the money on the check from the bank on which it was drawn and paid with it checks drawn on itself or used it in any other way in its business. * * * Had the check come to the hands of the assignee an order to deliver it to [the depositors] would have been proper. In such case the specific property would have been that of [the depositors]. As it was, there existed nothing but a cause of action against he bank for conversion of the check or of the money, its proceeds; and, as such, it stands on the same footing as any other claim upon the assigned assets based on a conversion of money or other property. To allow such claims to be paid in full out of the assets, when all claims cannot be paid in full, would give a preference to such claims. There is nothing in the insolvent law justifying it."

[2] Booth *v.* Welles, (1890) 42 Fed. Rep. 11.

CHAPTER XIV.

LIABILITY OF BANK SHAREHOLDERS.

§ 358. Rules generally.
359. Rule under Minnesota statute.
360. Rule under Michigan statute.
361. Stockholder relieved from liability by a sale of his stock through a broker.
362. Pledgee of stock incurs no liability.
363. When a stockholder is relieved from liability.
364. The rule where shares are transferred to avoid liability.
365. When a transfer of shares does not relieve the stockholder.
366. Liability of stockholder survives.
367. Liability of a married woman upon shares of stock held by her in her own right.
368. Rules as to actions to enforce liability of stockholders.

§ 358. Rules generally.— The stockholders of a banking corporation are primary debtors to the depositors, and are co-ordinately responsible with the bank. Its liability and that of the stockholders commences at the same time.[1] A subscriber for shares of the stock of a bank will be held responsible as a stockholder, though he may not have paid for his stock or received certificates therefor.[2] Persons who hold stock in pledge, the certificates of which stand on the books of the bank in the name of the pledgee, are, in contemplation of the National Banking Act, stockholders, and so long as they thus hold the stock in pledge are responsible to the creditors of the bank in proportion to the amount so held.[3] Subscription to the stock of a national bank, and payment in full with entry of name on its books as a stockholder, makes the subscriber a stockholder without taking out a certificate.[4] The responsibility of a stockholder in a national bank for further assessments on the stock will cease on his selling to the bank, as agent for an unknown principal, his stock, and

[1] Mitchell *v.* Beckman, (1883) 64 Cal. 117; citing Mokelumne Hill Canal & Mining Co. *v.* Woodbury, 14 Cal. 265.

[2] Mitchell *v.* Beckman, (1883) 64 Cal. 117; citing Chaffin *v.* Cummings, 37 Me. 83; Spear *v.* Crawford, 14 Wend. 20; Chester Glass Co. *v.* Dewey, 16 Mass. 94; In re South Mountain Consolidated Mining Co., 7 Sawy. 30.

[3] Magruder, etc., *v.* Colston, 44 Md. 349.

[4] Pacific National Bank *v.* Eaton, 141 U. S. 227; Thayer *v.* Butler, 141 U. S. 234; Butler *v.* Eaton, 141 U. S. 240.

delivering to the bank his certificate and power of attorney for transfer, in blank, though no formal transfer be made.[1] Where shares of stock in a national bank have been hypothecated, and placed in the hands of the transferee, the transferee will be subjected to all the liabilities of ordinary owners of shares. It is for the reason that the property is in his name and the legal ownership appears to be in him.[2] One who is chargeable as a shareholder in a national bank will not be relieved from his liability by failure on the part of an officer of the bank to comply with the provisions of the act as to these banking associations requiring a list of the stockholders to be kept, accessible to all persons, by reason of which he is not shown to be a shareholder.[3] In an action based upon an assessment made by the comptroller of the currency on the stockholders of a national bank the Supreme Court of the United States held that a transfer of stock in a bank to a person without his or her knowledge or consent did not of itself impose upon the transferee the liability attached by law to the position of a stockholder in the association; but if, after the transfer, the transferee approved or acquiesced in it, or in any way ratified it (as, for instance, by joining in an application to convert the bank, which was originally a savings bank in the District of Columbia, into a national bank), or accepted any benefit arising from the ownership of such stock, he or she became liable to be treated as a stockholder with such responsibility as the law imposed in the case of shareholders of a national banking association; and this liability would be the same whether new certificates had or had not been issued to the transferee after the transfer. And the indorsement by the payee of a check which appeared on its face to be drawn by the cashier of the bank in payment of a dividend due the payee as a stockholder, was held to estop the payee from

[1] Whitbeck *v.* Mercantile Bank, 127 U. S. 193.

[2] Wheelock *v.* Kost, (1875) 77 Ill. 296; citing Morse on Banking, 432; Adderly *v.* Storm, 6 Hill, 624; In re Empire City Bank, 18 N. Y. 199. The facts in Wheelock *v.* Kost, *supra*, were that the defendant made a loan to the bank, and made his promissory note partly as an accommodation to the bank, to be held among their other assets, and fifty shares of its stock, equal in value to $5,000, were issued to him, as security for his loans, and as indemnity against liability on his note. The court held him liable to the creditors of the bank as a stockholder. As to the liability of shareholders of a national bank to the creditors of the bank, see Laing *v.* Burley, 101 Ill. 591. As to stockholder's liability on obligations to a bank, see Finnell *v.* Sandford, (1856) 17 B. Mon. (Ky.) 758.

[3] Hale *v.* Walker, 31 Iowa, 344.

denying knowledge of its contents or ownership of the shares.[1] It has been held in a federal court that one who subscribed and paid for a specified number of shares of a "proposed increase" of the capital stock of a national bank, which increase, in fact, was never issued, and to whom the bank officials transferred, instead, old stock of the bank without his knowledge or consent, was not a "shareholder" within the meaning of that section of the Revised Statutes of the United States, which imposes individual liability on the shareholders for the debts of national banks. And the fact that such a subscriber for the new shares received a dividend on the old shares so transferred to him, did not estop him from denying his liability as a shareholder where such dividend was received in the belief that it was paid to him by virtue of his subscription to the proposed new stock.[2] It appeared in a case before the United States Supreme Court that some of the creditors of this bank, after it determined to go into voluntary liquidation, made settlements of their claims for some cash and certain papers belonging to the bank, indorsed and guaranteed by the president in the name of the bank. They afterwards reduced these claims, growing out of the indorsement or guaranty by the president, to judgment, and in the form of judgments against the bank presented them, and they were allowed a *pro rata* for the sums realized in this action of creditors against stockholders with the other creditors in the decree made. The Supreme Court held that this was erroneous.[3]

[1] Keyser *v.* Hitz, (1890) 133 U. S. 138; s. c., 10 Sup. Ct. Rep. 290.

[2] Stephens *v.* Follett, (1890) 43 Fed. Rep. 842.

[3] Richmond *v.* Irons, (1887) 121 U. S. 27. Mr. Justice MATTHEWS, for the court, said: "Those creditors who made settlements after the bank was put in liquidation, and received from the president in that settlement paper of the bank, or, as in some cases, the individual notes of [the president] himself, indorsed or guaranteed in the name of the bank, are not to be considered as creditors of the bank, entitled to subject the stockholders to individual liability. The individual liability of the stockholders, as imposed by and expressed in the statute, is, indeed, for all the contracts, debts and engagements of such association, but that must be restricted in its meaning to such contracts, debts and engagements as have been duly contracted in the ordinary course of its business. That business ceased when the bank went into liquidation; after that there was no authority on the part of the officers of the bank to transact any business in the name of the bank so as to bind its shareholders, except that which is implied in the duty of liquidation, unless such authority had been expressly conferred by the shareholders. No such express authority appears in this case, and the power of the president or other officer of the bank to bind it by transactions after it was put into liquidation is that which results by implication from the duty to wind up and close its affairs. That duty consists in the collection and reduction to money of the assets of the bank, and the payment of creditors equally and ratably, so far as the assets prove sufficient. Payments, of course, may be made in the bills receivable and other assets of the bank in *specie*, and the title to such paper may be transferred by the president or cashier by an indorsement suitable to the purpose in the name of the bank, but such indorsement and use of the name of the bank is in liquidation, and merely for the purpose of transferring title. It can have no other effect as against the shareholders by creating a new obligation. It does not constitute a liability, contract or engagement of the bank for which they can be held to be individually responsible. Every creditor of the bank, receiving its assets under such circumstances, knows the fact of liquidation, and is chargeable with knowledge of its consequences; he takes the assets received at his own peril; he is dealing with officers of the bank only for the purpose of winding up its affairs. If he accepts something in lieu of the existing obligations looking to future payment, it must be from other parties. It is not within the power of the officers of the bank, without express authority, by such means to prolong indefinitely an obligation on the part of the shareholders, which is imposed by the statute only as a means of securing the payment of debts of an insolvent bank when it is no longer able to continue business, and for the purpose of effectually winding up its affairs. This is the very meaning of the word 'liquidation.'" Mr. Justice STORY said, in Fleckner *v.* Bank of the United States, 8 Wheat. 338, 362: "Its ordinary sense, as given by lexicographers, is to clear away, to lessen debt, and in common parlance, especially among merchants, to liquidate the balance is to pay it." In White *v.* Knox, 111 U. S. 784, 787, it was said: "The business of the bank must stop when insolvency is declared." In National Bank *v.* Insurance Co., 104 U. S. 54, the liquidation of such an association was said to be like that which follows the dissolution of a copartnership.

§ 359. Rule under Minnesota statute.— One acquiring stock in a banking corporation incurs the statutory liability, not only in respect to corporate debts contracted after he became a stockholder, but also in respect to debts contracted before that time.[1]

[1] Olson *v.* State Bank, (Minn. 1894) 59 N. W. Rep. 635. Discussing the question GILFILLAN, Ch. J., said: "The decisions of the courts in the different states seem at variance, the greater number holding that those who own the stocks when the remedy is sought by the creditors — that is, when the action to enforce the liability is brought — are liable in respect to all the corporate debts, no matter whether contracted before or after they acquired their stock. The decisions in each state are based on the terms of the statute in each, as construed by the court; and, as the terms of the statutes in the different states vary, but little aid is afforded by the decisions in other states. Our statute is Gen. St. 1878, chap. 33, § 14: 'Every person becoming a stockholder therein, shall, in proportion to his interest, succeed to all the rights and be subject to all the liabilities of prior stockholders.' Section 2: 'And the stockholders in each

§ 360. Rules under Michigan statute.—In an action by the receiver of an insolvent bank to enforce the liability of a stockholder under the provisions of the Banking Act of the state of Michigan, declaring that "the stockholders of every bank shall be individually liable, equally and ratably, and not one for another, for the benefit of the depositors in said bank to the amount of their stock at the par value thereof, in addition to the said stock, * * *" it appeared by the record that, about the time the bank was organized, the defendant negotiated with one who became cashier of the bank for the purchase of stock. It appeared from the stock ledger that under a certain date there was issued to defendant a certificate of stock, the stock ledger stating that the stock was transferred from a subscription of another. It further appeared that a certificate was, in fact, issued to the defendant, and that he received dividends for several years. It was claimed for the defendant that he was not a stockholder, and urged further that, not being an original subscriber to the capital stock, the only way in which he could become a stockholder was by securing a transfer of some of the stock subscribed for by others, and that no formal transfer appeared upon the bank books, and, hence, that he never legally became a stockholder.

bank shall be individually liable in an amount equal to double the amount of stock owned by them for all the debts of such bank, and such individual liability shall continue for one year after any transfer or sale of stock by any stockholder or stockholders.' The terms 'all the debts of such bank' are general, unqualified, and include all debts, without regard to when incurred. To exclude from their meaning those incurred prior to becoming a stockholder we would have to add after the word 'bank' some such words as 'contracted after they acquired the stock,' and to hold that the legislature, while intending what such words would mean, omitted, for some reason or other, to express such meaning by apt terms. But the point was really decided in this state thirty years ago, and the decision has been acquiesced in, accepted and regarded as the law ever since, till questioned in this case. In Gebhard *v.* Eastman, 7 Minn. 56, the court construes a statute somewhat less emphatic in its terms than section 21, chapter 33. The terms in that case were, 'Each of the stockholders of said company shall be personally liable for the debts of said company to an amount equal to the amount of capital stock held by such stockholder, and no more.' It was held that the act created a personal liability against each stockholder at the time that the debt was contracted, 'and all that may voluntarily become so at any subsequent period prior to satisfaction.' Noting that this statute does what that did not, to wit, limit the liability to one year after the stockholder shall have transferred his stock, that decision disposes of the question here in hand."

The Supreme Court of Michigan held adversely to this contention.[1] The court also held adversely to the other contention on the part of the defendant, that, if he ever legally assumed the relation of stockholder, he was induced to enter into the contract by fraud.[2]

[1] Bissell, Receiver, *v.* Heath, (1894) 98 Mich. 472. The court said: "The answer to this [contention] is that the evidence of the transfer was sufficient to satisfy the corporators. The stock was, in fact, issued, and the books of the company showed it sufficiently. Grand Rapids Savings Bank *v.* Warren, 52 Mich. 557. The corporation was bound by the issue of the stock. It could waive the formality of any assignment by [the original subscriber to the stock], and, having done so, could not thereafter deny defendant's rights on the ground that he had failed to produce evidence of an assignment from an original subscriber to the capital stock." Citing Mor. Priv. Corp. § 844.

[2] Bissell, Receiver, *v.* Heath, (1894) 98 Mich. 472. It was said by the court that it was "conceded by [defendant's] counsel that there are authorities which maintain that it is not open to a stockholder, when the rights of creditors have intervened, to assert the claim that he was induced by fraud to become a stockholder; but it is insisted that the true rule is that asserted by Lord Cairns in Smith's Case, 2 Ch. App. 604, that it is one of the risks which creditors are liable to that it may turn out that some person whose name appears as stockholder on the list has a right to have his name taken from the list. In the case cited, however," said the court, "the action was taken before any steps had been taken to wind up the affairs of the corporation under the Winding Up Act." They then proceeded to discuss the questions involved, as follows: "In Stone *v.* Bank, 3 C. P. Div. 282, it was held that where the corporation has gone into liquidation, and is proceeding under the Winding Up Act, to make calls to satisfy claims of creditors, it is too late for one who has, up to that time, allowed his name to appear as a stockholder, to avoid liability on the ground that his subscription was obtained by fraud. The question was touched upon by this court in Duffield *v.* Wire & Iron Works, 64 Mich. 293. In that case plaintiff had been induced to become a stockholder by fraud, and, on discovery of the fraud, tendered back the shares and dividends received, and brought an action against the corporation before any assignment was made for the benefit of creditors. On the question of the plaintiff's right to recover, under the circumstances, the court was evenly divided, Justices Champlin and Morse, being of the opinion that the plaintiff could not rescind the contract after the rights of creditors had intervened, even though no steps had actually been taken to wind up the affairs of the corporation. Chief Justice Campbell and Mr. Justice Sherwood were of the opposite opinion. We do not deem it necessary to decide which of the two opinions we would follow in a case presenting the same state of facts, as we think that, even under the doctrine of Justice Campbell's opinion, the defendant in this case cannot be relieved. Justice Campbell lays stress upon the fact that, under the statute relating to manufacturing corporations, the stockholders are not personally liable to contribute beyond what will pay up for their stock, and that creditors cannot enforce any rights against fully-

§ 361. Stockholder relieved from liability by a sale of his stock through a broker.— In an action brought by the receiver of a national bank to charge defendant as a stockholder, it appeared that the latter, in good faith, and without intent to evade his responsibility as a stockholder, the owner of a number of its shares, sold them to a broker, to whom he delivered his stock certificate, and a power to transfer them, leaving blanks for the names of the attorney and transferee. The broker sold them to the president of the bank, who gave his individual check in payment therefor, and received the certificate and power. By the directions of the president, a bookkeeper of the bank inserted his own name as attorney, and transferred the stock to the president of the bank as "trustee" on the official stock register. The entries in the stock ledger and other books of the bank showed that the president purchased the stock for the bank, and reimbursed himself with its funds. The bookkeeper had actual knowledge of all the facts. The argument of the receiver, before the Supreme Court of the United States, to support his action, praying that the purchase on the part of the bank be set aside, and that the defendant be compelled to repay the money received to him and the president of the bank to re-transfer to him the shares on the books of the bank, was substantially that the transfer of the stock was not complete until made on the books of the bank, and the attorney who made it knew that the purchase was by the bank and with its funds, and his knowledge was the knowledge of defendant. The court held that as the bookkeeper was the agent of the bank, his knowledge of the transaction could not be imputed to the defendant, and that the suit could not be maintained.[1]

paid stock. But such is not the case with corporations organized under the Banking Law. It is apparent that Justice CAMPBELL recognized the doctrine of Stone *v.* Bank, *supra*. We think that the defendant in this case cannot, after having permitted the depositors of the bank to rely upon his apparent ownership of this stock, and after having received dividends upon the stock for years, which he has not tendered back, be heard now to repudiate his liability." Citing Mor. Priv. Corp. § 840; Chubb *v.* Upton, 95 U. S. 665; Cook Stock & S. §§ 163, 164.

[1] Johnson *v.* Laflin, (1880) 103 U. S. 800. *Arguendo*, Mr. Justice FIELD, in the opinion, said: "The general doctrine that the principal in a transaction is chargeable with notice of matters affecting its validity, coming to the knowledge of his agent pending the proceeding, is not questioned. Had * * * the bookkeeper been appointed by [defendant] to make the sale, and had he, in negotiating it, learned the facts as to the purchase and use of the funds of the bank, there would be ground to invoke the application of the doctrine. But such was not the position of [the bookkeeper] to [defendant]. The sale was consummated, so far as [defendant] was concerned, when he delivered the certificate, with the power to transfer it to the broker. The latter did not mention the name of the principal for whom he was acting. He declined to give it. [Defendant] had a right, therefore, to treat him as the principal, and if he was competent to make the purchase the sale was valid." As to the transfer of such shares, generally, it was then said: "Shares in the capital stock of associations, under the National Banking Law, are salable and transferable at the will of the owner. They are, in that respect, like other personal property. The statute recognizes this transferability, although it authorizes every association to prescribe the manner of their transfer. Its power in that respect, however, can only go to the extent of prescribing conditions essential to the protection of the association against fraudulent transfers, or such as may be designed to evade the just responsibility of the stockholder. It is to be exercised reasonably. Under the pretense of prescribing the manner of the transfer, the association cannot clog the transfer with useless restrictions, or make it dependent upon the consent of the directors or their stockholders. * * * As between [defendant] and the broker, the transaction was consummated when the certificate was delivered to the latter with the blank power of attorney indorsed, and the money was received from him. As between them the title to the shares then passed; whether that be deemed a legal or equitable one matters not; the right to the shares then vested in the purchaser. The entry of the transaction on the books of the bank, where stock is sold, is required, not for the translation of the title, but for the protection of the parties and others dealing with the bank, and to enable it to know who are its stockholders entitled to vote at their meetings and receive dividends when declared. It is necessary to protect the seller against subsequent liability as a stockholder, and perhaps also to protect the purchaser against proceedings of the seller's creditors. Purchasers and creditors, in the absence of other knowledge, are only bound to look to the books of registry of the bank. But, as between the parties to a sale, it is enough that the certificate is delivered with authority to the purchaser, or any one he may name, to transfer it on the books of the company and the price is paid. If a subsequent transfer of the certificate be refused by the bank, it can be compelled at the instance of either of them. Bank *v.* Lanier, 11 Wall. 369; Webster *v.* Upton, 91 U. S. 65; Bank of Utica *v.* Smalley, 2 Cow. 770; Gilbert *v.* Manchester Iron Co., 11 Wend. 627; Commercial Bank of Buffalo *v.* Kortright, 22 Wend. 348; Sargeant *v.* Franklin Insurance Co., 8 Pick. 90. The transferability of shares in the national banks is not governed by different rules from those which are ordinarily applied to the transfer of shares in other corporate

§ 362. Pledgee of stock incurs no liability.— In a case before the Supreme Court of the United States it was held that a pledgee of shares of stock in a national bank, who, in good faith and with no fraudulent intent, takes the security for his benefit in the name of an irresponsible trustee for the avowed purpose

of avoiding individual liability as a shareholder, and who exercises none of the powers or rights of a stockholder, incurs no liability as such to creditors of the bank in case of its failure.[1] A corporation which holds shares of stock in a national bank as collateral security for a loan, and is carried on the registry of the

bodies. The power of attorney indorsed in the certificate is usually written or printed, with a space in blank for the name of the attorney to be inserted for the accommodation of the purchaser. The subsequent filling up of the blank by him with another name instead of his own, as it may suit his convenience, does not so connect the vendor with the party named as to charge him with the latter's knowledge and thus affect the previous transaction. * * *" The court did not consider that the further position of the receiver in this action, that the assets of the bank constituted a trust fund for the benefit of its creditors, and, where wrongfully diverted, could be followed in whosesoever hands they could be traced, had application to this case. It was said: "Here no assets of the bank were received by [defendant]. What he received came from the broker, the only person with whom he dealt or whom he knew as principal in the negotiation. The circumstance that the purchase was actually in the interest of the bank — though of that fact the broker was ignorant — cannot affect the latter's character as principal, so far as [defendant] was concerned, which he bore in the negotiation. The whole transaction on the part of [defendant] was free from any imputation of fraud. He sold his shares to a person competent to purchase and hold them and received the stipulated price. It would be a perversion of justice and of the ordinary rules governing men in commercial transactions to hold the sale, under such circumstances, vitiated by the relations of the purchaser to others, of which the seller had no knowledge, or any grounds to entertain a suspicion. The validity of the sale of stock cannot be made to depend upon the accident of the immediate purchaser, or of the party to whom he may transfer the certificate, in filling up the blank in the power of attorney with the name of a person to make the formal transfer, who is acquainted with the secret interest of others in the shares purchased. The validity of a sale and its completeness must be determined by the relation which the contracting parties at the time openly bear to each other."

[1] Anderson *v.* Philadelphia Warehouse Company, (1884) 111 U. S. 479, MILLER and MATTHEWS, JJ., dissenting. WAITE, Ch. J., in his opinion for the majority of the court, said: "It is well settled that one who allows himself to appear on the books of a national bank as an owner of its stock is liable to creditors as a shareholder, whether he be the absolute owner or a pledgee only, and that if a registered owner, acting in bad faith, transfers his stock in a failing bank to an irresponsible person for the purpose of escaping liability, or if his transfer is colorable only, the transaction is void as to creditors. National Bank *v.* Case, 99 U S. 628; Bowden *v.* Johnson, 107 U. S. 251. It is also undoubtedly true that the beneficial owner of stock registered in the name of an irresponsible person may, under some circumstances, be liable to creditors as the real shareholder, but it has never, to my knowledge, been held that a mere pledgee of stock is chargeable, where he is not registered as owner." In the conclusion of the opinion it was said: "The security of

bank as the holder of such stock "as pledgee," is not subject, on the bank's insolvency, to the statutory liability of a stockholder.[1] One who is entered on the books of a national bank as the owner of stock, but who is admitted to hold the stock for the true owner, is not liable as a stockholder for the debts of the bank, when the true owner has been adjudged so liable, though nothing may be realized upon the execution of the judgment against the true owner.[2]

the warehouse company was perfected without imposing on the company a shareholder's liability. All this was done in good faith when the bank was in good credit and paying large dividends, and years before its failure, or even its embarrassment. So far as the company was concerned the transfer [to one of its employees] was not made to escape an impending calamity, but to avoid incurring a liability it was unwilling to assume, and which it was at perfect liberty to shun." In the dissenting opinion, rendered by MILLER, J., it was said: "I think if in any case between private persons one of them had placed property in the hands of minors, servants, or other irresponsible persons, for the purpose of escaping the responsibility attaching to the ownership of such property, while securing all the advantages of such ownership, it would be held to be a transaction which could not be supported on any legal or equitable principle. It does not remove this case from the control of that principle that the parties to be injured are the unknown creditors of the bank, who are, by this means, deprived of the right which they have to resort to a responsible shareholder for the contribution which the law gives for their benefit. If not an actual fraud, it is a fraud upon the Banking Law, and was so intended to be by both the original holders of the bank shares and the officers of the warehouse company, by which the latter could control the shares without the responsibility which the law attaches to the owner."

[1] Pauly *v.* State Loan & Trust Co., (1893) 56 Fed. Rep. 430. It was said by the court: "The precise question involved was not presented in any of the numerous cases cited by counsel. But, in my opinion, the doctrine of the case of Anderson *v.* Warehouse Co., 111 U. S. 479; s. c., 4 Sup. Ct. Rep. 525, carried to its logical conclusion, exempts the defendant from the liability with which it is sought to be charged. In that case the Supreme Court, while declaring it to be well settled that one who allows himself to appear on the books of a national bank as an owner of its stock is liable to the creditors as a shareholder, whether he be the absolute owner or pledgee only, and that if a registered owner, acting in bad faith, transfers his stock in a failing bank to an irresponsible person, for the purpose of escaping liability, or if his transfer is colorable only, the transaction is void as to creditors, and that it is also true that the beneficial owner of stock registered in the name of an irresponsible person may, under some circumstances, be liable to creditors as the real shareholder, said it knew of no case that held that a mere pledgee of stock is chargeable where he is not registered as owner."

[2] Yardley *v.* Wilgus, (1893) 56 Fed. Rep. 965.

§ 363. When a stockholder is relieved from liability.— It appeared in an action by a receiver of a national bank to enforce an assessment under the Revised Statutes of the United States, section 5151, against a person credited on the transfer books as a stockholder, that nearly a year before the failure of the bank he had sold this stock to a broker for an indisclosed principal; that he indorsed the same, and requested the broker to inform the cashier of the transaction, and to have the stock transferred; that the broker accordingly handed the stock to the cashier, gave him the necessary information, and requested him to make the transfer. This the cashier promised to do, but, in fact, the transfer was never made. The certificate recited that it was transferable on the books of the company "by indorsement hereon and surrender of this certificate." It was held by the United States Circuit Court for the northern district of California that, in requesting the cashier to make the transfer, the broker acted as the seller's agent, and that the latter did all that was required of him as a prudent business man, and could not be held liable as a stockholder.[1]

§ 364. The rule where shares are transferred to avoid liability.— In an action by a receiver of an insolvent national bank against the transferrer and transferee of shares where the testimony showed to the minds of the Supreme Court of the United States that there was an attempt on the part of a holder of shares of stock in a national bank to escape personal liability as a shareholder by collusion with and transfer of the shares to one not solvent and responsible, the court, after reciting the section of Revised Statutes applicable to the matter, thus declared the law governing in such case: "As [a] shareholder, [the transferrer] became subject to the individual liability prescribed by the statute. This liability attached to him until, without fraud as against the creditors of the bank for whose protection the liability was imposed, he should relieve himself from it. He could do so by a *bona fide* transfer of the stock. But where the transferrer, possessed of information showing that there is good ground to apprehend the failure of the bank, colludes and combines, as in this case, with an irresponsible transferee, with the design of substituting the latter in his place, and of thus leaving no one with any ability to respond for the individual liability imposed by the statute, in respect of the shares of stock transferred, the transaction will be decreed to be a fraud on the creditors, and he will be held to the same liability to the creditors as before the transfer. He will be still regarded as a shareholder *quoad* the creditors, although he may be able to show that there was a full or a partial consideration for the transfer, as between him and the transferee. The appellees contend that the statute does not admit of such a rule, because it declares that every person becoming a shareholder by transfer succeeds to all the liabilities of the prior holder, and that, therefore, the liabilities of the prior holder, as a stockholder, are extinguished by the transfer. But it was held by this court in National Bank *v.* Case, 99 U. S. 628, that a transfer on the books of the bank is not in all cases enough to extinguish liability. The court in that case defined as one limit of the right to transfer that the transfer must be out and out, or one really transferring the ownership as between the parties to it. But there is nothing in the statute excluding, as another limit, that the transfer must not be to a person known to be irresponsible, and collusively made with the intent of escaping liability and defeating the rights given by statute to creditors. [The transferee here] might be liable as a shareholder succeeding to the liabilities of [the transferrer], because he has voluntarily assumed that position; but that is no reason why [the transferrer] should not, at the election of creditors, still be treated as a shareholder, he having, to escape liability, perpetrated a fraud on the statute. This is the view enforced by the decision of the chief justice in Davis *v.* Stevens, 17 Blatchf. 259."[1]

[1] Young *v.* McKay, (1892) 50 Fed. Rep. 394, following Whitney *v.* Butler, 118 U. S. 655; s. c., 7 Sup. Ct. Rep. 61. The court distinguished Richmond *v.* Irons, 121 U. S. 27; s. c., 7 Sup. Ct. Rep. 788.

§ 365. When a transfer of shares does not relieve the stockholder.— In a case before the United States Supreme Court it appeared that a stockholder claimed that he had sold his stock, one hundred and fifty shares, about seven months before the resolution of the directors to go into voluntary liquidation; fifty shares about three months before, and fifty shares on or about the date of the passage of that resolution, and that he was not liable. The stock books of the bank showed a transfer of the

[1] Bowden *v.* Johnson, (1882) 107 U. S. 251, 261 262.

shares partly on the last date, and partly afterwards. The court sustained the decree against him by the Circuit Court.[1]

§ 366. Liability of stockholder survives.— There has been a case before the Supreme Court of the United States, a bill filed by the creditors of a national bank which had by resolution of its directors gone into voluntary liquidation to enforce the statutory liability of the stockholders, in which the court passed upon and determined several questions raised in the case. One question raised upon the appeal of one of the respondents, who had been appointed after the institution of the suit an administrator *de bonis non* of one of the original defendant stockholders, was upon the contention of this administrator that the personal liability of his intestate did not survive as against the adminis-

[1] Richmond *v.* Irons, (1887) 121 U. S. 27. Mr. Justice MATTHEWS, speaking for the court, said: "As to the fifty shares of stock sold by [appellant] to the president of the bank [on the day of the adoption of the resolutions for liquidation], we think the conclusion cannot be resisted that the transaction was made in contemplation of the insolvency of the bank, and although both parties may have believed that the bank would ultimately be able to pay all of its debts notwithstanding this transaction, we think that, as against creditors, it was fraudulent in law, and to that extent [appellant] is chargeable as a shareholder. The sale of [the shares held previously] there is no reason to suppose were not made in entire good faith, and without any expectation on the part of the parties of the insolvency of the bank. Notwithstanding that, [appellant] continued to be upon the books of the bank the owner of the shares until [the date of the action of directors looking to liquidation of the bank], and the day after, when they were * * * transferred. By § 5139 of the Revised Statutes, those persons only have the rights and liabilities of stockholders who appear to be such as are registered on the books of the association, the stock being transferable only in that way. No person becomes a shareholder, subject to such liabilities, and succeeding to such rights, except by such transfer; until such transfer, the prior holder is the stockholder for all the purposes of the law. It follows, therefore, that [appellant], in respect to the shares [previously] sold by him, was the statutory owner on the day [of the passage of the resolution]. His liability as such stockholder is the same as if he had that day sold and transferred the stock to [the president], but such a sale and transfer could only have been made by [appellant], who was himself a director, in contemplation and actual knowledge of the suspension of the bank; it would operate as a fraud on the creditors, an effect which the law will not permit. The case is not within the rule laid down in Whitney *v.* Butler, 118 U. S. 655. Here there is no proof, as there was in that case, of the delivery of the certificates to the bank, and a power of attorney authorizing its transfer, with a request to do so, made at the time of the transaction. The delivery was to [the purchaser], not as president, but as vendee."

trator, and that, therefore, no decree could be rendered against him subjecting the estate of his intestate in his hands for administration to the liability under the statute. The court held that such a decree could be rendered.[1] In a very late action in a federal court by a receiver of an insolvent national bank against the executors of a deceased shareholder, a portion of his shares of stock having been redeemed from the pledgee of the same by paying the debt for which it was pledged and these shares issued to them as executors, to recover an assessment made upon shareholders, the executors took this among their positions with reference to the right to recover, that no claim existed against the estate; that when testator died, the bank was then a going concern, and his liability to be assessed upon the shares of stock owned by him was merely a contingency, and that his estate in the hands of the executors could only be subject to the payment of such demands as were existing claims at the time of the death of the testator. The court held adversely to this contention and rendered a decree holding the estate liable.[1]

[1] Richmond *v.* Irons, (1887) 121 U. S. 27. Mr. Justice MATTHEWS, for the court, said: "The judicial decisions more directly relied upon by the appellant in support of [his] contention are those of Dane *v.* Dane Manufacturing Co., 14 Gray, 488; Bacon *v.* Pomeroy, 104 Mass. 577; Ripley *v.* Sampson, 10 Pick. 371; Bangs *v.* Lincoln, 10 Gray, 600; Gray *v.* Coffin, 9 Cush. 192. These cases, however, so far as they are in point, are based upon the particular language of the statutes of Massachusetts, materially differing from that contained in the National Banking Act. Under that act the individual liability of the stockholders is an essential element in the contract by which the stockholders became members of the corporation. It is voluntarily entered into by subscribing for and accepting shares of stock. Its obligation becomes a part of every contract, debt and engagement of the bank itself, as much so as if they were made directly by the stockholder instead of by the corporation. There is nothing in the statute to indicate that the obligation arising upon these undertakings and promises should not have the same force and effect, and be as binding in all respects, as any other contracts of the individual stockholder. We hold, therefore, that the obligation of the stockholder survives as against his personal representatives. Flash *v.* Conn, 109 U. S. 371; Hobart *v.* Johnson, 19 Blatchf. 359. In Massachusetts, it was held in Grew *v.* Breed, 10 Met. 569, that administrators of deceased stockholders were chargeable in equity, as for other debts of their intestate, in their representative capacity."

[1] Wickham *v.* Hull, (1894) 60 Fed. Rep. 326. SHIRAS, D. J., said: "The liability to respond to assessments made upon the capital stock is purely statutory in its origin, and the extent and nature of the obligation is determined by the provisions of the statute creating the same. Section 5151 of the Revised Statutes enacts that 'the shareholders of every national banking

§ 367. Liability of a married woman upon shares of stock held by her in her own right.— The shareholder who was being sued for an assessment ordered by the comptroller of the currency upon the shareholders of this national bank, being a married woman, contended that the coverture, at the time of the transfer of stock to her, as well as when the bank failed, protected her against assessment upon the stock paid in her name

association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares.' Under the provisions of this section, there existed a personal liability against [the testator] for all contracts, debts and engagements of the bank in force at the date of his death. After his death, no additional liability could be created against [testator] personally by the creation of new debts or obligations on part of the bank. Provision for such cases is made in section 5152, Revised Statutes, in which it is enacted that 'persons holding stock as executors, administrators, guardians or trustees, shall not be personally subject to any liabilities as stockholders, but the estates and funds in their hands shall be liable in like manner and to the same extent as the testator, intestate ward or person interested in such trust funds would be if living and competent to act and hold the stock in his own name.' Upon the death of a stockholder, the legal title of the shares may pass to his executor or administrator, but the liability for the debts of the bank does not follow the transfer of the title to the executor or administrator, but the statute declares that the liability for the debts shall attach to the estate of the deceased. In other words, the estate is put in the place of the deceased owner, and the statutory liability will exist against the estate and not against the executor individually. In Richmond *v.* Irons, 121 U. S. 27–55; s. c., 7 Sup. Ct. Rep. 788, it was contended that the personal liability of the intestate for assessments upon the capital stock did not survive as against an administrator, nor as against the funds of the estate in his hands; but this contention was overruled, it being held that, under the provisions of the National Bank Act, 'the individual liability of the stockholders is an essential element in the contract by which the stockholders became members of the corporation. There is nothing in the statute to indicate that the obligation arising upon these undertakings and promises shall not have the same force and effect and be as binding in all respects as any other contracts of the individual stockholder. We hold, therefore, that the obligation of the stockholder survives as against his personal representatives.' Under the ruling of the Supreme Court in that case, if, at the time of the death of [this testator], there existed a personal liability against him, under the provisions of section 5151, Revised Statutes, such liability would survive against his executors; and if the liability was created after his death, and while the shares of stock formed part of his estate, then, under the provisions of section 5152, the estate became responsible for such liability, and under either state of facts a claim would exist against the estate."

upon the books of the bank. The Supreme Court of the United States held that a married woman in the District of Columbia, of which she was a resident at the time of these transactions, might become a holder of stock in a national banking association, and assume all the liabilities of such a shareholder, although the consideration might have proceeded wholly from her husband; also, that the coverture of a married woman who was a shareholder in a national bank did not prevent the receiver of a bank from recovering judgment against her for the amount of an assessment levied upon the shareholders equally and ratably under the statute.[1] Applying the provision of the Code of North Carolina, that no woman during coverture shall be capable of making any contract to affect her real and personal estate without the written consent of her husband, in a suit by a receiver of a national banking association against a married woman to recover an assessment made upon the stockholders by the comptroller of currency, it was held that a purchase of stock in a bank by a married woman was not a "contract" within the terms of the statute, and

[1] Keyser *v.* Hitz, (1890) 133 U. S. 138; s. c., 10 Sup. Ct. Rep. 290. The court, speaking through Mr. Justice HARLAN, referred to the case of the Reciprocity Bank, 22 N. Y. 9, 15, which involved the liability of a married woman as a shareholder in a state bank, as instructive. It was said: "The Constitution and statutes of New York made the shareholders in corporations and joint-stock associations for banking purposes, issuing bank notes, 'individually responsible,' etc. The Court of Appeals of that state, speaking by Chief Justice COMSTOCK, said: 'It is also said that *femes covert* are not liable to suit or judgment at the common law, and in general this is true. It is also true that the apportionment of liability among stockholders in banks, when duly confirmed, becomes a judgment against each stockholder, to be enforced by execution as in other cases. But it was competent for the legislature to depart from this rule and analogies of the common law, and to make married women and their estates liable in this proceeding as other stockholders in banks are made liable. This, we think, has been done, and it seems to us proper to add that we see no reason why it ought not to be done, in order to effectuate the policy on which the constitutional provision and the statute are founded. It might go far to defeat the policy if married women could take and hold stock without liability to the creditors.' See, also, Sayles *v.* Bates, 15 R. I. 345. This question arose in Anderson *v.* Line, in the Circuit Court of the United States for the eastern district of Pennsylvania, where it was held by Judge MCKENNAN that a married woman was not exempted by reason of her coverture from the liability imposed by congress upon shareholders in national banks. 14 Fed. Rep. 405. To the same effect is the decision of Judge WHEELER in Witters *v.* Sowles, 32 Fed. Rep. 767."

that the wife was liable upon the assessment, although the stock was purchased without the written consent of her husband.[1]

§ 368. Rules as to actions to enforce liability of stockholders.— One becoming a stockholder in a national bank thereby submits himself to the provisions of the National Bank Act, and becomes liable to be assessed to the extent of his statutory liability for all debts of the bank existing while he holds his stock.[2] An assessment made upon stockholders of a national bank for the payment of the debts of the bank may be collected by the receiver by an action at law against the stockholders; and in such an action the stockholders cannot inquire into the legality of the receiver's appointment. Furthermore, in such an action the complaint need only allege that the comptroller determined that the assessment was necessary and levied it, as such an assessment by the comptroller is conclusive against the stockholders.[3] In an action of this kind, the fact that defendant's name appears on the subscription list of the corporation, and that he paid assessments on the stock subscribed, are sufficient evidence that he was a stockholder.[4] Actions by a receiver of a national bank against stockholders for assessments on the stock are subject to the state Statutes of Limitations.[5] A decree on a creditor's bill taken against a stockholder of a national bank, on the basis that his shares of stock bore to the whole stock of a bank, has been held by the Illinois Supreme Court not to be erroneous.[6]

[1] Robinson *v.* Turrentine, (1894) 59 Fed. Rep. 554.

[2] Young *v.* Wempe, (1891) 46 Fed. Rep. 354.

[3] Ibid. See, as sustaining the text, Kennedy *v.* Gibson, 8 Wall. 498; Casey *v.* Galli, 94 U. S. 673; Bank *v.* Case, 99 U. S. 628; Bailey *v.* Sawyer, 4 Dill. 463; Strong *v.* Southworth, 8 Ben. 331; Stanton *v.* Wilkeson, 8 Ben. 357; Welles *v.* Stout, 38 Fed. Rep. 67; Richmond *v.* Irons, 121 U. S. 27; s. c., 7 Sup. Ct. Rep. 788.

[4] Glenn *v.* McAllister's Exrs., (1891) 46 Fed. Rep. 883; Turnbull *v.* Payson, 95 U. S. 418; Glenn *v.* Springs, 26 Fed. Rep. 494; Vanderwerken *v.* Glenn, 85 Va. 9; s. c., 6 S. E. Rep. 806; Glenn *v.* Orr, 96 N.C. 413; s. c., 2 S. E. Rep. 538.

[5] Butler *v.* Poole, (1890) 44 Fed. Rep. 586.

[6] Wheelock *v.* Kost, (1875) 77 Ill. 296. See Pollard *v.* Bailey, 20 Wall. 520.

CHAPTER XV.

OFFICERS OF NATIONAL BANKS — CRIMINAL ACTS.

§ 369. Misapplication of funds by officers.
370. Making "false entries" in reports, etc.
371. Improper certification of check.
372. Restrictions of Banking Law of New York upon banks and their officers.

§ 369. Misapplication of funds by officers.— Benedict, D. J., has held, in the prosecution of the president of a national bank for misapplication of its funds, that the indictment alleging that he "unlawfully and willfully, and with intent to injure and defraud the said association, for the use, benefit and advantage of himself, did misapply certain of the money and funds of said association, which he * * * then and there, with the intent aforesaid, paid, and caused to be paid," to certain persons named, was bad for failure to allege the facts that made such payment unlawful or criminal.[1] And it is not essential that an indictment in such a case should allege that the acts charged were done without the knowledge and assent of the directors of the association, for such knowledge and assent would not relieve the president from liability for an unlawful or continual misappropriation of the bank's funds.[2] These rules have been declared by the United

[1] United States *v.* Eno, (1893) 56 Fed. Rep. 218. It was said: "The law controlling on this occasion has been settled by the Supreme Court of the United States. The only duty devolving upon this court in this case is to apply that law to the indictment found against the defendant. By the law declared by the Supreme Court in Britton's Case, 107 U. S. 669; s. c., 2 Sup. Ct. Rep. 512, an indictment for a misapplication of the funds of a national bank must specify the particulars of the appropriation, so as to show the application charged to be a criminal misapplication as distinguished from applications that are unlawful but not criminal. There must be averments to show how the application was made, and that it was an unlawful one." And in Northway's Case, 120 U. S. 332; s. c., 7 Sup. Ct. Rep. 580, it is said by the Supreme Court: "It is of the essence of the criminality of the misapplication that there should be a conversion of the funds to the use of the defendant, or of some person other than the association."

[2] United States *v.* Eno, (1893) 56 Fed. Rep. 218, 220. It was said: "The statute does not make absence of authority from the directors an ingredient in the crime of misapplication. I conceive that a conversion of the funds of a national bank by its president may be a criminal misapplication of the funds of the bank, although done with the knowledge and assent of the directors

States Supreme Court as to indictments of national bank officers under the Revised Statutes of the United States, section 5209: In such an indictment, for willfully misapplying the funds of a national bank, it is not necessary to charge that the moneys and funds alleged to have been misapplied had been previously intrusted to the defendant; since a willful and criminal misapplication of the funds of the association may be made by its officer or agent without having previously received them into his personal possession. In charging in an indictment the president of a bank with aiding and abetting its cashier in the misapplication of the funds of the bank, it is not necessary to prove that he then and there knew that the person so aided and abetted was the cashier. An indictment which charges in substance that the defendant was president and agent of a certain national bank theretofore duly organized and established, and then existing and doing business, under the laws of the United States, and that being such president and agent, he did then and there "willfully and unlawfully, and with intent to injure the said national banking association, and without the knowledge and consent thereof, abstract and convert to his own use certain moneys and funds of the property of the said association of the amount and value," etc., sufficiently describes and identifies the crime of abstracting the funds of the bank created by the section of the Revised Statutes above referred to. An indictment which charges that the defendant "was then and there president and agent of a certain national banking association, to wit, [naming the association], theretofore duly organized and established and then existing and doing business at [naming the place], under the laws of the United States," sufficiently states that that bank was organized under the National Banking Act, or to carry on the business of banking under a law of the United States.[1]

§ 370. Making "false entries" in reports, etc.— The offense of making false entries on the books of a national bank,

of the bank. The president of a national bank is not the association, nor are the president and directors the association. They are only officers of the association. The moneys of the stockholders and of the depositors in the association are not the moneys of these officers, but of the association, and it has not yet been held that a national bank may be pillaged of such moneys by its president with impunity, provided the act be done in pursuance of a conspiracy between the president and the directors, or a majority of them."

[1] United States *v.* Northway, (1887) 120 U. S. 327.

for which an officer of the bank is subject to indictment for and punishment under the United States Revised Statutes, section 5209, it not being a crime of which the state courts have concurrent jurisdiction under the United States Revised Statutes, section 5328, is exclusively cognizable by the federal courts.[1] A president of a national bank was indicted for aiding and abetting in the making of false entries and also for making false entries in the books of the bank with intent to injure, deceive, or defraud, etc., under Revised Statutes of the United States, section 5209, in the northern district of Illinois. Blodgett, J., of the United States Circuit Court, held that such entries must be willfully and intentionally false, and that mere clerical mistakes or an arbitrary exercise of discretion in keeping the books, not amounting to an abuse thereof, were insufficient to constitute the offense. That, under charge of the indictment of making false entries in a report to the comptroller of the currency, it was no defense that such entries were made by a clerk and verified by the president without actual knowledge of the truth, it being his duty to inform himself, and especially in this case as regarded items showing assets and liabilities. That under the charge of making false entries in this report to the comptroller of the currency, with the intention to injure and defraud the banking association and the stockholders thereof, and to deceive its directors, it was not sufficient to prove an intent to deceive other persons, such as creditors, depositors, the comptroller, or the public. That the testimony of a bank examiner, who was a skilled accountant, was admissible to show false entries; but that it must consist of knowledge derived from his investigation of the books, and not of conclusions based partly upon statements of officers and clerks of the bank. The rule prescribed for the jury as to determining the president's guilty intent was that they should consider his relation to the bank as an officer and a shareholder, assistance given the bank by him in its embarrassment by the loan of his individual money, and whether he had any motive for making false entries, together with circumstances that may have induced him to do so, such as an examination by the officers of the bank's affairs at the time the entries were made; and, where the president's fraudulent intent was not sufficiently shown, evidence of his good character would resolve the doubts in his favor,

[1] In re Eno, (1893) 54 Fed. Rep. 669, following Bank *v.* Dearing, 91 U. S. 29.

but not if his guilt was conclusively proven.[1] HAMMOND, J., of the United States Circuit Court for the southern district of Ohio, has declared the following rules in the prosecution of officers of a national bank for the offense of making false entries, under section 5209 of the Revised Statutes of the United States, to wit: Directors of a national bank are "officers" within the meaning of this section which makes it a misdemeanor for bank officers to make false entries in any book, report or statement of the bank, with intent to deceive any of its officers. Under the statute, intention to deceive any one director or officer is as criminal as the intention to deceive all of them. A conviction cannot be had under the statute where it appears that the officers alleged to have been deceived were accomplices in the speculation, to hide which the false entries were made. If such false entries had a natural tendency to deceive the bank officers, the fact that defendants deny having had any such actual intent cannot rebut the presumptions of intent arising from the nature of the entries themselves. In such case the fact that the officers in question were not actually deceived is not conclusive proof of the absence of intent to deceive.[2] It has been held in the United States District Court for the eastern district of Pennsylvania that false entries in a statement, made by a bookkeeper of a national bank at the request of the bank examiner, purporting to give the balances due depositors, which statement it was the duty of the examiner to make and not of the bookkeeper, would not sustain an indictment for making "false entries in * * * a statement of the association," under Revised Statutes United States, section 5209.[3] The indictment of certain of the officers of a national bank for making "false" entries, etc., in violation of United States Revised Statutes, section 5209, charging the directors with making false entries in a report to the comptroller of the currency on the condition of the bank, PUTNAM, Circuit Judge, held could not be sustained under that section, as under United States Revised Statutes, section 5211, the sole duty of the directors

[1] United States *v.* Allen, (1880) 47 Fed. Rep. 696.

[2] United States *v.* Means, (1889) 42 Fed. Rep. 599. As to what was a sufficient indictment against the president of a national banking association for making false entries in book, report or statement of such association under section 5209 of the Revised Statutes of the United States, see United States *v.* Hughitt, (1891) 45 Fed. Rep. 47.

[3] United States *v.* Eqe, (1892) 49 Fed. Rep. 852.

in regard to the reports to the comptroller is to attest them by their signatures; and entries by the directors would be mere spoliation and "false" within the meaning of section 5209. As to certain technical objections to the indictment for this offense, it was held that the use in the indictment of the words "them and others," in alleging that the defendant was president or director of such bank, and that he made alleged false entries, was not uncertain or repugnant merely because in one place the words might in one place refer to the whole of a day and in another to only one instant of the day; also, that the omission of the signs for dollars and cents in the recitals of the alleged false entries in the reports to the comptroller, and misnomer of the reports, were immaterial where the reports were set out by their tenor in the indictment, so that those discrepancies were at the most mere "matter of form" within the meaning of United States Revised Statutes, section 1025, for which the indictment is not "to be deemed insufficient." And it need not be alleged specifically in an indictment for this offense that the reports were transmitted to the comptroller of the currency, or that they were published.[1] Upon a reargument of some of the questions involved in this case, PUTNAM, Circuit Judge, held that the indictment for making false entries against the president of the national bank, charging that it was done "with intent to injure and defraud the said association and certain persons to the grand jurors unknown," was sufficient so far as concerned the allegations of intent.[2] The indictment alleging that the false entries in question indicated that there was then in the paying teller's department of the bank a certain amount in gold, legal tenders and gold certificates when such amount was not there in fact, it was not necessary that the indictment should further allege that such amount was not then in other departments of the bank.[3] The indictment, in addition to the entries themselves, need set out the context only when it so modified the entries as to be, in presumption of law, a part of them. The indictment was not invalidated by the fact that the note teller's and paying teller's books, in which it was charged the president made the false entries on which the indictment was based, were usually kept by those officers without interference by

[1] United States *v.* Potter, (1892) 56 Fed. Rep. 83.

[2] Following U. S. *v.* Britton, 107 U. S. 655; s. c., 2 Sup. Ct. Rep. 512.

[3] Ibid.

the president. The court held counts charging false entries by the president in reports of the condition of the bank, which alleged that the reports were made in conformity with the law, and then set them out by their tenor, to be bad for their failure to allege specifically that the reports were verified and attested by the cashier.[1] In a case against one of the directors of this same national bank, in which he was charged with a violation of United States Revised Statutes, section 5209, relating to the making of false entries, PUTNAM, Circuit Judge, held that it was an indictable offense under that section to make a false entry in a report to the comptroller of the currency, or to aid and abet the making of such an entry. He also declined to construe an allegation in the indictment that defendant "did make a certain false entry in a certain report of the said association," to mean that the entry was made after the report was completed, and was in fact an alteration. For the purposes of the section prescribing the offense, and for an indictment drawn under it, the preparation and completion of the report to the comptroller, the making of the false entry therein, its verification, attestation and delivery to the comptroller might be considered simultaneous, and there was, consequently, he held, no repugnance in failing to allege in the indictment that any or all of these things occurred in consecutive order. And though the count in this indictment, for aiding and abetting the cashier in making the false entries, described defendant as "being then and there a director of the bank concerned," it could not be held that the counts charged him with aiding and abetting in his official character. Counts in the indictment charging the defendant with procuring and counseling the false entry before the fact were held valid, such acts being covered by the clause of the section extending the penalty to any one who "abets" an officer or agent in the acts prohibited. The entry, the tenor of which was set forth, contained the words "see schedule." It was held not to be a valid objection to the indictment that those words were not explained, it being necessary to set out the context only when it is presumptively a part of what

[1] United States *v.* Potter, (1892) 56 Fed. Rep. 97. The court reviewed the cases of U. S. *v.* Britton, 108 U. S. 193; s. c., 2 Sup. Ct. Rep. 526; Claassen *v.* U. S., 142 U. S. 140; s. c., 12 Sup. Ct. Rep. 169; U. S. *v.* Eqe, 49 Fed. Rep. 852; U. S. *v.* Northway, 120 U. S. 327; s. c., 7 Sup. Ct. Rep. 580; Cross *v.* North Carolina, 132 U. S. 131; s. c., 10 Sup. Ct. Rep. 47.

is set out. In such a case it is sufficient for the indictment to allege the substance of the reports to the comptroller, for whether they are such reports as the law requires can be determined by the court from the allegations that they were made in response to the comptroller's order, and the allegations touching their attestation, verification and other like matters.[1] In the United States District Court for the northern district of Iowa, on the indictment of an officer of a national bank for making false entries in reports to the comptroller, the court, in its instructions to the jury, declared these rules: A "false entry" in a report by national bank officers or directors to the comptroller, within the meaning of Revised Statutes United States, section 5209, is not merely an incorrect entry made through inadvertence, negligence or mistake, but is an entry known to the maker to be untrue and incorrect, and by him intentionally entered, while so knowing its false and untrue character. A national bank is not required to conform the headings of the various accounts on its books to any prescribed names, nor to the names stated in the form of report prescribed by the comptroller; and, therefore, when a report is called for, if the person making it enters under the headings in the prescribed form a statement of the bank's condition, which is true in respect to the headings in said form, he has fulfilled the demands of the law. The entry of "Loans and Discounts" in reports to the comptroller does not guarantee the solvency of the makers of the paper, but is a statement that in truth and fact at the date named in the report the bank actually held and owned "loans and discounts" to the aggregate so reported. It is not making a "false entry" within the meaning of the statute, to enter in such report, under heading of "Loans and Discounts," items which, on books of the bank, and for convenience of its officers, have been temporarily withdrawn from that heading, and which are, from day to day, carried on books of the bank under heading of "Suspended Loans," while awaiting action of directors as to same being withdrawn from character of loans, and entered up as a loss on "Profit and Loss" account.[2] In determining whether the entry, under heading of "Loans and Discounts" in such report, of certain corporation bonds which were secured by mortgage, and owned by the bank, was the making of a "false entry,"

[1] United States *v.* French, (1893) 57 Fed. Rep. 382.

[2] United States *v.* Graves, (1892) 53 Fed. Rep. 634.

within the meaning of the statute, the jury may consider the fact that on the prescribed form of report, after a heading of "U. S. Bonds," there is a heading of "Other Stocks, Bonds," etc., and that, in the report made, certain other corporation bonds, owned by the bank, in large amounts, were entered under the latter heading. Where the form of report as presented by the comptroller contains heading of "Loans and Discounts," and also of "Overdrafts," it is the duty of the bank officer to make his entries in such report in such manner that each of the headings shall truthfully state the condition of his bank as to such heading; and he is not justified in entering overdrafts which are being carried on the books of the bank as "Overdrafts" as "Loans and Discounts," merely because he regards an overdraft as a temporary, indefinite loan, nor because those two headings are both found among the "Resources" of the bank; but he should report the overdrafts which are carried on the books of the bank as "overdrafts" in the heading of "Overdrafts," and thereby correctly show the character of the bank's resources in this particular. In determining whether defendant made a "false entry," within the meaning of the statute, when he included in such report, as "Loans and Discounts" of the bank, amounts which were being carried on the books of the bank as "Overdrafts," the jury will not consider whether other national banks followed the same practice. Such practice, if it existed, would not change defendant's statutory duty; but the jury, in determining whether such entry, if a "false entry," was made with intent to deceive and defraud, may consider whatever knowledge defendant is shown to have had as to the practice of any other national bank in this respect.[1] A director of a bank is personally liable to the bank on paper made to it by a firm of which he is a member, and in making a report of the condition of the bank to the comptroller, the amount of such paper should be entered under the heading of "Liabilities of Directors (Individual and firm) as Payers;" and, in determining whether the omission of such an item from this heading was made with intent to deceive, etc., the jury may consider what effect, if any, upon defendant's action in this respect, was caused by the receipt of a letter from the comptroller, prior to the making of the report, calling the attention of the bank officials to the excessive amount of the loans made by the bank to its directors,

[1] Ibid.

and demanding immediate reduction thereof. In determining whether a certain false entry, made by a national bank officer in a report to the comptroller, was made with intent to deceive or defraud, etc., within the meaning of the statute, the jury are authorized to infer the intent, if the natural and legitimate result of such "false entry" would be to deceive any other officer or officers of the bank, or any agent appointed to examine into its affairs. It is not necessary to complete the offense of making a "false entry" in a report to the comptroller of currency of the condition of a national bank, with intent to deceive or defraud, that any person should have been in fact actually deceived, or defrauded, for the making of such a "false entry," with the intent to deceive or defraud, is sufficient.[1]

§ 371. **Improper certification of check.**— In this case the officer of a national banking association was indicted for a violation of the act of congress of July 12, 1882, chapter 290, section 13, amendatory of the United States Revised Statutes, section 5208, which makes it a misdemeanor for any officer, clerk or agent of any national banking association to "certify any check" drawn by a person who did not then have on deposit sufficient money to meet the same, PUTNAM, Circuit Judge, held that such indictment need not allege delivery of the check by the bank after the certification. The statute prohibits the certification of checks "before the amount thereof shall have been regularly entered to the credit of the drawer on the books of the banking association;" and the section of the Revised Statutes of which the statute was amendatory prohibits the certification unless the drawer "has on deposit with the association, at the time such check is certified, an amount of money equal to the amount of such check." There were counts in the indictment simply charging that the checks were certified contrary to the prohibition of the statute, and others charging that after certification the checks were authenticated by the paying teller. It was held that, inasmuch as the counts alleged the certification as an accomplished act, it would not be presumed that the authentication was any essential part of it; and it followed that it was not necessary to allege the absence of the required credit or deposit at the time the authentication was made. The indict-

[1] Ibid.

ment was held sufficient, it having charged in the language of the statute under which defendant was indicted that the drawer of the check had not on deposit, at the time it was certified, "an amount of money equal to that specified" in the check. Neither did the indictment charge two offenses in the same count by alleging in that count that the check was certified "before the amount thereof had been entered to the credit of the drawer on the books of the bank," and also at a time when the drawer did not "have on deposit an amount of money equal to" the amount of the check. He also held that an indictment against the president of the national bank for "aiding and abetting" the cashier in certifying checks under the prohibited circumstances could not be sustained, the statutes being of narrow range and directed only against the person who committed the act directly, or perhaps by so intimidating or overpowering another that the latter became the mere physical instrument of the former.[1] Upon appeal of this case to the United States Supreme Court it was held that a charge in an indictment that the defendant was president of a national bank, and, as such, on a day and at a place named, unlawfully, knowingly and willfully certified a certain check (describing it) drawn upon the bank, and that the drawer did not then and there have on deposit with the bank an amount of money equal to the amount specified in the check, has been held to sufficiently aver the offense described in the United States Revised Statutes, section 5208.[2] The United States Supreme

[1] United States *v.* Potter, (1892) 56 Fed. Rep. 83.

[2] Potter *v.* United States, (1894) 155 U. S. 438. Mr. Justice BREWER said: "The word 'certify,' as commonly understood, implies that the cheque, upon which the words of certification have been written, has passed from the custody of the bank and into the hands of some other party, and when the charge is that the defendant did unlawfully, knowingly and willfully certify a certain cheque, the import of that accusation is not simply that he wrote certain words on the face of the cheque, but that he did it in such a manner as to create an obligation of the bank in such a way as to make an instrument which can properly be called a certified cheque. And the subsequent recital, 'by then and there writing, placing and putting in and upon and over the face of said cheque the words and figures following,' etc., is not to be taken as absolutely limiting the import of the word 'certified' to the mere act of so writing, placing, etc., but as simply descriptive of the form of the certification of that which he personally did. It was not necessary to constitute the offense that he should himself deliver the cheque to some third party outside the bank, or even that he should take any part in such delivery. His offense would be complete if, after he had written the words of certification as stated, with the intent that they should be used to create a contract on the part of the bank the actual delivery had been made by some clerk or other officer of the bank without his actual knowledge."

Court held that as it is of the essence of the offense against those acts that the criminal act should have been done willfully, a person charged with it would be entitled to have submitted to the jury, on the question of "willful" wrongdoing, evidence of an agreement on the part of the officers of the bank that it should be treated as a loan from day to day secured by ample collateral, and that for the check certified each day there was deposited each day an ample amount of cash.[1]

§ 372. Restrictions of Banking Law of New York upon banks and their officers.— The Banking Law of the state of New York, as amended, has placed a number of restrictions upon banks and their officers in this state. They are as follows: No corporation or banker shall make any loan or discount to any person, company, corporation or firm, or upon paper upon which any such person, company, corporation or firm may be liable, to any amount exceeding the one-fifth part of its capital stock actually paid in and surplus; but the discount of bills of exchange drawn in good faith against actually existing values, or of commercial or business paper actually owned by the person negotiating the same, shall not be considered as a part of any such loan or discount. No such corporation, nor any of its directors, officers, agents or servants, shall directly or indirectly purchase or be interested in the purchase of any promissory note or other evidence of debt issued by it for a less sum than shall appear on the face thereof to be due. Every person violating the provisions of this subdivision shall forfeit to the people of the state three times the nominal amount of the note or other evidence of debt so purchased. No president, director, cashier, clerk or agent of any such corporation, and no person in any way interested or concerned in the management of its affairs, shall, as individuals, discount or directly or indirectly make any loan upon any note or other evidence of debt which he shall know to have been offered for discount to such corporation and to have been refused. Every person violating the provisions of this subdivision shall, for each offense, forfeit to the people of the state

[1] Potter *v.* United States, (1894) 155 U. S. 438.

twice the amount of the loan which he shall have made. No officer, director, clerk or agent of any bank or savings bank shall borrow from the corporation with which he is officially connected any sum of money without the consent and approval of a majority of the board of directors or trustees thereof. Every person violating this provision shall, for each offense, forfeit to the people of the state twice the amount which he shall have borrowed. No such corporation shall make any loan or discount on the security of the shares of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and stock so purchased or acquired shall, within six months from the time of its purchase, be sold or disposed of at public or private sale. Every person violating the provisions of this subdivision shall forfeit to the people of the state twice the nominal amount of such stock.[1]

[1] Laws of N. Y. 1895, chap. 929, amending § 25, art. 1, chap. 689, Laws of N. Y. 1892.

CHAPTER XVI.

FISCAL MANAGEMENT — PUBLIC CORPORATIONS.

§ 373. The power of county commissioners under statutes of Nebraska as to purchase of lands for a poor farm.
374. Power of a building commission of a town in Connecticut.
375. For what purposes a board of education in Connecticut cannot use the public funds.
376. Management of school funds of the state by an auditor of a county under Indiana statutes.
377. Erroneous payments into the treasury of a county by a county treasurer under Indiana statutes — his right to recover the same.
§ 378. For what a school district may settle account of an ex-assessor.
379. The board of auditors of a town may be ordered to pay a judgment against the town for interest on its bonds.
380. The right of a de facto county treasurer to salary.
381. Payments to city official in excess of his salary may be recovered of him.
382. Compelling a ministerial officer to distribute the fund in his hands.
383. County warrants — their issue and validity—rules governing.
384. Statute of Limitations not applicable to county warrants.

§ 373. The power of county commissioners under statutes of Nebraska as to purchase of lands for a poor farm.— The statutes of Nebraska authorize the purchase by the county commissioners of each county of lands for a poorhouse, and further empower them "to receive donations to aid in the establishment of such poorhouse; and, also, * * * from time to time, as they shall see fit, to levy and collect a tax, not exceeding one per cent, on the taxable property in the county, and to appropriate the same to the purchase of land * * *." Parties who had sold land to a county for this purpose under a contract for part cash, and upon conveyance of the land the commissioners, to execute the note of the county and a mortgage upon the land as a security, brought action in the courts of that state to recover damages from the county for its refusal to accept a deed and execute the note and mortgage contemplated. The Supreme Court affirmed a judgment sustaining a demurrer to the petition on the ground that the contract was illegal and void, there being

no authority under the statute to execute a note and mortgage.[1] One who had made a similar contract with the county commissioners of a county in Nebraska, and had executed and delivered a deed of the lands for a poor farm, and had received in part payment notes payable at different times, with a mortgage upon the property to secure it, and one who was the holder of these notes, upon the county's failure to pay them, filed a bill in the United States Circuit Court praying a rescission of the contract and a reconveyance or a recovery of the amount due upon the notes. The relief prayed for was not granted by this court. On appeal the Supreme Court of the United States held that it was error to refuse the relief prayed for; that the complainants were entitled to recover of the county the unpaid balance or to have the contract rescinded upon the return of the money they had received from the county on account of the contract.[2] It was

[1] Stewart *v.* Otoe County, 2 Neb. 177. The court said: "There is no authority of law for the county commissioners to bind the county in the manner contemplated. They cannot give a promissory note, nor can they mortgage the property of the county. Should they formally do so, their action would be a nullity. In the purchase of land for a poor farm the authority of the commissioners of a county is very clearly set forth. The mode of raising the money and paying it over are all definitely stated. These statutes set a limit beyond which they cannot go. They are a guide not only to the commissioners, but equally so to all persons dealing with them, who must see to it that their contracts are within the boundaries thus described. * * * Here we find the authority, and, indeed, the only authority, for the purchase and payment of money for a 'poor farm' by the county commissioners; and here, too, are specially designated the money that may be used for that purpose, together with the mode of raising it. But there is not one word about mortgaging the property of the county to secure the payment of the purchase money at a given time. The statutes provide the only security that can be given. The public faith is pledged, and a tax not exceeding one per cent may be levied upon all the taxable property of the county annually, and, when collected, paid to the person entitled thereto by an order upon the treasurer of the county, payable out of the special fund."

[2] Chapman *v.* County of Douglas, (1882) 107 U. S. 348. *Arguendo*, Mr. Justice MATTHEWS, for the court, said: "In the present case * * * it was not the understanding of the parties that the vendor should await the collection of taxes, as prescribed by the statute, for the payment of the purchase money; but, on the contrary, there was an agreement for payment in a definite time, without regard to the condition of the county treasury, and for security by way of notes and mortgages. The agreement, as we have assumed, so far as it relates to the time and mode of payment, is void; but the contract for the sale itself has been executed on the part of the vendor by the delivery of the deed, and his title at law has actually passed to the county. As the agreement between the parties has failed by reason of the legal disability of the county to perform its part, according to its conditions, the right of the vendor to rescind the contract and to a restitution of his title would seem to be as clear as it would be just, unless some valid reason to the contrary can be shown. As was said by this court in Marsh *v.* Fulton County, 10 Wall. 676, 684, and repeated in Louisiana *v.* Wood, 102 U. S. 294, 'the obligation to do justice rests upon all persons, natural and artificial, and if a county obtains the money or property of others without authority, the law, independent of any statute, will compel restitution or compensation.' See, also, Miltenberger *v.* Cooke, 18 Wall. 421. The illegality in the contract related not to its substance, but only to a specific mode of performance, and does not bring it within that class mentioned by Mr. Justice BRADLEY in Thomas *v.* City of Richmond, 12 Wall. 349. The purchase itself, as we have seen, was expressly authorized. The agreement for definite times of payment and for security alone was not authorized. It was not illegal in the sense of being prohibited as an offense; the power in that form was simply withheld. The policy of the law extends no farther than merely to defeat what it does not permit, and imposes upon the parties no penalty. It thus falls within the rule, as stated by Mr. Pollock in his Principles of Contract, 264: 'Where no penalty is imposed, and the intention of the legislature appears to be simply that the agreement is not to be enforced, then neither the agreement itself nor the performance of it is to be treated as unlawful for any other purpose.' Johnson *v.* Meeker, 1 Wis. 436. The principle was applied in the case of Morville *v.* American Tract Society, 123 Mass. 129, 137, where it was said: 'The money of the plaintiff was taken and is still held by the defendant under an agreement which it is contended it had no power to make, and which, if it had power to make, it has wholly failed on its part to perform. It was money of the plaintiff, now in the possession of the defendant, which in equity and good conscience it ought now to pay over, and which may be recovered in an action for money had and received. The illegality is not that which arises where the contract is in violation of public policy or of sound morals, and under which the law will give no aid to either party. The plaintiff himself is chargeable with no illegal act, and the corporation is the only one at fault in exceeding its corporate powers by making the express contract. The plaintiff is not seeking to enforce that contract, but only to recover his own money and prevent the defendant from unjustly retaining the benefit of its own illegal act. He is doing nothing which must be regarded as a necessary affirmance of an illegal act.' The decision of this court in Hitchcock *v.* Galveston, 96 U. S. 341, 350, covers the very point. There a recovery was allowed for the value of the benefit conferred upon the municipal corporation, notwithstanding, and, indeed, for the reason that the contract to pay in bonds was held to be illegal and void. 'It matters not,' said the court, 'that the promise was to pay in a manner not authorized by law. If payments cannot be made in bonds because their issue is *ultra vires*, it would be sanctioning rank injustice

claimed in this case that the Statute of Limitations of Nebraska barring the right to recover the title to real estate after ten years from the time it first accrued would defeat recovery on the part

of the complainants. The Supreme Court held against the contention.[1]

§ 374. Power of a building commission of a town in Connecticut.— The town meeting of a Connecticut town voted for the appointment of a commission to determine upon a plan for an almshouse which it had determined to construct, and to secure

to hold that payment need not be made at all. Such is not the law.' This doctrine was fully recognized by the Supreme Court of Nebraska as the law of that state in the case of Clark *v.* Saline County, 9 Neb. 516, in which it adopts from the decision of the Supreme Court of California in Pimental *v.* City of San Francisco, 21 Cal. 362, the following language: 'The city is not exempted from the common obligation to do justice which binds individuals. Such obligations rest upon all persons, whether natural or artificial. If the city obtain the money of another by mistake or without authority of law, it is her duty to refund it from this general obligation. If she obtain other property which does not belong to her, it is her duty to restore it, or, if used, to render an equivalent therefor from the like obligation.' Argenti *v.* San Francisco, 16 Cal. 282. The legal liability springs from the moral duty to make restitution." The court further referred to Parkersburg *v.* Brown, 106 U. S. 487, and Crampton *v.* Zabriskie, 101 U. S. 601, as supporting their ruling in this case.

[1] Chapman *v.* County of Douglas, (1882) 107 U. S. 348. The court referred to Brewer *v.* Otoe County, 1 Neb. 373, quite at length, and then said: "But the more satisfactory answer to this defense is that none of the statutes of limitation referred to apply to the case at all. We have already seen that by the decision in Brewer *v.* Otoe County, 1 Neb. 373, it is the declared law of Nebraska that the claim against the county for the purchase money, on the supposition that the understanding had been to accept payment according to the terms of the statute, was not liable to the bar of the limitation acts. So that the obligation of the county to pay would not be extinguished by the statutory lapse of time. Now, although the right of [the vendor here] to rescind the contract and demand a re-conveyance occurred at the very date of the deed, he was not bound to exercise the right, and his cause of action did not accrue until he had made manifest his election. He had the right to treat as null that part of the contract which was illegal, and having executed it on his part, to waive performance according to its terms on the part of the county, and wait a reasonable length of time for the county to make the payment in the mode made lawful by the statute before executing his power to rescind the contract. Until that time had elapsed, and until, after that, [he] had elected to rescind, there was no existing cause of action, and consequently nothing upon which the Statute of Limitations could begin to take effect. When that reasonable time expired we have no means of determining. It would depend upon circumstances not disclosed in the record, such as the state of the county treasury, the extent of its other obligations, the value of the taxable property, and its general financial condition. There is nothing whatever to show that the delay that had taken place in filing the present bill has been unreasonable. It is impossible, therefore, to say that any Statute of Limitations has ever begun to run against the cause of action, much less that its bar has become complete."

proposals and let to the lowest responsible bidders. The committee, by a majority vote, awarded the contract to persons other than the lowest responsible bidder, and a taxpayer sought by action to enjoin the selectmen of the town and the commission from entering into any contract for the construction of the almshouse, except with the lowest responsible bidder. The Supreme Court held that it was error on the part of the lower court to make the injunction permanent.[1]

§ 375. For what purposes a board of education in Connecticut cannot use the public funds.— In an action of a tax-

[1] Dibble *v.* Town of New Haven, (1887) 56 Conn. 199. Upon the powers of municipalities in this respect it was said by the court: "In the expenditure of money in the discharge of a governmental duty, a municipality is as an individual managing his private affairs. That is, a majority of the voters therein may determine whether it shall perform its duty as economically as it can, or with as large an outlay as it pleases, and the minority, in the absence of fraud, must submit to the action of the majority, finding its protection against unnecessary expenditure in the law of self-interest, to which all men are presumed to be in a greater or less degree obedient; and in making expenditures for such purpose the will of the municipality is a law unto itself, as is that of an individual to himself, and as little subject to judicial control; and if it appoints an agent to make contracts in its name for such purposes, a court has no greater power to restrain that agent than it has to restrain the agent of an individual. If, in the case before us, we should assume that the committee proposes to exceed the powers granted to it by the municipality, there would yet be no foundation for the injunction. Every person dealing with it must take notice of the limitations imposed upon it by the appointing vote. If with such knowledge any one undertakes to enter into a contract with it which it is without power to make, he takes nothing by his action. The municipality is not bound to him; no taxpayer is in danger of loss, and there is no occasion for judicial intervention. Again, if the committee should, in excess of its powers, in form enter into a contract with one not the lowest bidder, the municipality may, upon knowledge, when lawfully assembled for that purpose, ratify and adopt its acts, against the protest of an individual taxpayer, or against that of a minority. And if, in strict execution of power, the committee should bind the town by a contract, the town may break it, pay the consequent damages, and make the expenditure in another manner and to a larger amount. These acts of ratification or of change the minority is powerless to prevent. It results, therefore, that, unless there should be an assumption of obligation on the part of the town in due and legal form, no person has any cause of action against it, and no taxpayer is in danger of loss. After such

payer to restrain the members and officers of the board of education of a school district in Connecticut, from paying out the money of the district for the defense of a suit brought against certain members and ex-members of the board, for malicious and wrongful acts in connection with their duties as members of the board, the powers of a school district of that state in respect to expenditures of the moneys of the district was considered by the Supreme Court. It was held in this case, where the members of the board were sued for an injury to the business reputation of the plaintiffs by their refusal to entertain a bid offered by them for furnishing stationery for the district, on the ground that they had some time before dealt dishonestly with the district, that the matter was one in which the district as such had no interest and that its money could not be used for the defense of the suit.[1]

assumption there will be a legally authorized expenditure, and that no taxpayer can resist."

[1] Hotchkiss *v.* Plunkett, (1891) 60 Conn. 230. The court said, generally: "In order to justify the expenditure of money by a municipal corporation in the indemnity of one of its officers for a loss incurred in the discharge of their official duty, three things must appear: *First*, the officer must have been acting in a matter in which the corporation had an interest. *Second*, he must have been acting in discharge of a duty imposed or authorized by law. And, *third*, he must have acted in good faith. Gregory *v.* City of Bridgeport, 41 Conn. 76; Merrill *v.* Plainfield, 45 N. H. 126; Vincent *v.* Inhab. of Nantucket, 12 Cush. 103; Dillon on Mun. Corp. (4th ed.) § 219. School districts are *quasi* corporations of a public nature, with limited powers, strictly defined by statute, and they have no right to raise money by assessment and appropriate the same to purposes not within the scope of those powers, even though a majority of their inhabitants expressly vote so to raise and appropriate it. Berlin *v.* New Britain, 9 Conn. 180; West School District *v.* Merrills, 12 Conn. 438; Bartlett *v.* Kinsley, 15 Conn. 327, 335. The powers of school districts [under the Connecticut statutes are thus expressed]: 'Every school district shall be a body corporate and have power * * * to purchase, receive, hold and convey real and personal property for school purposes; to build, purchase, hire and repair school houses and supply them with fuel, furniture and other appendages and accommodations; * * * to purchase globes, maps, blackboards and other school apparatus; to establish and maintain a school library; to employ teachers, except for such time as the town may direct the school visitors to employ the teachers, and pay the wages of such teachers as are employed by the district committee in conformity to law; to pay taxes and borrow money for all the foregoing purposes * * *.' There is no authority conferred on a school district to raise money other than such as is conferred by this statute. The grant of power to raise money for the specified purposes is doubtless a prohibition of the raising of money for any other purposes." The opinion concludes with this declaration by the court: "In any case it would be a demnity to one of its own officers in very grave question whether a municipal corporation could make an indemnity any other way than by a vote in a meeting duly called for that purpose."

§ 376. Management of school funds of the state by an auditor of a county under Indiana statutes.—The owner of real estate borrowed of the auditor of a county in Indiana money belonging to the school funds of the state, and a mortgage upon the land was given to secure it. There were changes of title to the land. One holding it paid the money due on the mortgage to the county auditor. The auditor thereupon indorsed upon the mortgage his certificate that the mortgage had been fully paid and satisfied, assigned and attested it, attached the seal of his office thereto and surrendered the notes and mortgage to the one paying it, and the latter caused the certificate of satisfaction to be duly and properly entered of record by the recorder of the county on the record of the mortgage in his office. On the same day the auditor entered on the register of loans kept by him as auditor in his office, a statement that the loan in question was fully paid and satisfied. The defendant in an action to foreclose this mortgage afterwards purchased this land, relying upon the record showing the satisfaction of the mortgage, and in good faith paid for it its full value without any knowledge whatever that the loan had not been in fact paid. The auditor, it appeared, appropriated the money to his own use and never paid any part of the same into the treasury of the county. In one place the statutes of Indiana provide that "All loans refunded and all interest shall be paid to the county treasurer, and his receipt shall be filed with the county auditor, who shall give the payer a quietus therefor and make proper entries." In another, that "Whenever the amount due on any mortgage shall be paid, and the treasurer's receipt therefor filed, the auditor shall indorse on the note and mortgage that the same has been fully satisfied, and surrender the same to the person entitled thereto, and on production of the same thus indorsed the recorder shall enter satisfaction upon the record." The contentions of the plaintiff were that the auditor had no power to enter the mortgage satisfied until the money was actually paid to the county treasurer and his receipt therefor filed with such auditor, and that an entry of satisfaction without the existence of such payment and receipt was a nullity, and was the same as a forgery, and that the office of the county treasurer and

the office of the county auditor were public offices, and that an examination of such offices would have disclosed the fact that the mortgage had not in fact been paid, and inasmuch as the defendant did not examine these offices he was guilty of negligence and should not be protected. The Supreme Court thought the entry of satisfaction upon the school fund mortgage in question stood upon a different footing from a forged entry, saying further: "A forged entry would be without any authority whatever, while the entry under consideration is genuine, and made by an officer having authority to make it," the statute conferring such authority directly upon the county auditor. They said further: "It is true that the entry of satisfaction before the payment of the money to the treasurer was wrongful, but inasmuch as the auditor had the money in his hands ready to hand over to the treasurer there was no want of authority." [1]

[1] Slaughter *v.* State ex rel., (1892) 132 Ind. 465, 466, 467. As to the right of the defendant to rely upon the records it was said: "As a rule the evidence of title and of recorded liens is to be found in the county recorder's office. Judgments rendered in court constitute one exception to the rule. By reason of the statute, which declares that school fund mortgages shall be deemed recorded from the date of their execution, they seem to constitute another exception. Deming *v.* State ex rel., 23 Ind. 416; Stockwell *v.* State ex rel., 101 Ind. 1. The satisfaction entered by the auditor upon the mortgage was properly recorded by the county recorder, and an examination of records in his office disclosed an unincumbered title to the land in dispute. We think the [defendant] had the right to rely upon such records. The general rule is that a public officer is presumed to have done his duty, and until the contrary is shown he is presumed to have acted rightly. Mechem Public Offices & Officers, §§ 579–677. This author says: 'The law constantly presumes that public officers charged with the performance of official duty have not neglected the same, but have performed it at the proper time and in the proper manner.' § 579, *supra*. Finding the school fund mortgage satisfied by the proper county officers, the only persons who could satisfy the same, we think the [defendant] had the right to presume, without looking further, that the county auditor had proceeded regularly, and that the mortgage debt had in fact been paid to the county treasurer before such satisfaction was entered. The county auditor in the most solemn manner, attested by the seal of his office, had published to the world that the debt was paid, and the [defendant], in our opinion, was under no more obligation to make further inquiry than he would have been had the mortgage debt been payable to a private individual who had entered the mortgage satisfied. The county auditor was the agent of [the] state, clothed with power to make such satisfaction, and the state, we think, is bound by his acts. The general rule is that the state, as well as municipal corporations, is bound by the acts of its officers when they act within the scope of their authority." Citing Dill. on Mun. Corp. pp. 321, 322; Mechem Public Offices & Officers, § 824; Martel *v.* City of East St. Louis, 94 Ill. 67; Roby *v.* City of Chicago, 64 Ill. 447; Board, etc., *v.* City of Lincoln, 81 Ill. 156; 2 Herm. on Est. & Res. Adj. 1264; Big. on Est. (5th ed.) 598; Curnen *v.* Mayor, etc., 79 N. Y. 511; O'Leary *v.* Board, etc., 93 N. Y. 1; People *v.* Stephens, 71 N. Y. 527.

§ 377. Erroneous payments into the treasury of a county by a county treasurer under Indiana statutes — his right to recover the same. — An Indiana statute provides as follows: "Whenever it shall appear to the board doing county business in any of the counties of this state, by clear and sufficient proof, that, by reason of erroneous charges in the tax duplicate, or from any other cause, the treasurer of such county has paid and accounted to such board for more money than was justly due from him on account of county revenue, said board doing county business shall direct the auditor to credit said treasurer with the sum or sums thus improperly paid, and order the same to be refunded from the county treasury." [1] In a county treasurer's action against the county to recover certain amounts of money which he claimed to have been erroneously paid into the county treasury, the Supreme Court of that state held that the statute required that, before such an action could be brought against the county, the claim should be presented to the board of commissioners, proofs of its correctness be made to them, and the board determine the propriety of refunding the same, and make a proper order in the matter; also, that when clear and sufficient proofs were made in such a case, the board would have no right to refuse to make the order and thus end the claim. In this particular case, there being no evidence in the record that the claim of the treasurer had not been submitted to the board for its action under the statute, the court held the action maintainable and affirmed the judgment in the treasurer's favor so far as items outside of what he claimed to have erroneously paid into the county treasury on account of taxes due the state. As to those amounts paid in on account of the state, it was held that he could have no recovery from the county for them. [2]

[1] R. S. Ind. § 6510.

[2] Board of Comrs. of Gilson County *v.* Tichenor, (1891) 129 Ind. 562. The court said: "[The statute] relates to county revenue only. We think it was the intention of the legislature that the county should not profit by the mistakes of its officers, by which it received into its treasury money to which it was not entitled; but there is nothing in the act from which it can be inferred that it was the legislative intent that the county should reimburse the

§ 378. For what a school district may settle account of an ex-assessor.— In an action against the guarantor of certain town orders which were taken in part settlement of a claim for moneys of a school district from an ex-assessor, in accordance with a resolution of the electors of the district at a legal meeting, as it seemed, authorizing a settlement with him for part cash and part in these town orders to be guaranteed by this defendant, it was contended that, if this settlement was authorized by the electors of the district at a legal meeting, still it was unauthorized by law; that it was beyond the power of the district to accept a chose in action in such settlement; that the only remedy of the school district was a suit upon the bond of the ex-assessor to collect the amount due from him. It did not appear from the record before the Supreme Court of Michigan whether the ex-assessor had ever given a bond, or whether, in case he did, he or his sureties were responsible. The court held that, in the case of a defaulting assessor, the electors of the school district might, at a regular meeting, authorize a settlement of the matter and direct that the amount due might be paid in part by township orders guaranteed by a responsible party, as was done in this case.[1]

§ 379. The board of auditors of a town may be ordered to pay a judgment against the town for interest on its bonds.— In the federal court for the northern district of Illinois the court awarded a peremptory mandamus to a town board of auditors that they audit and certify as a valid debt

treasurer for money paid to the state, or to the townships, or to corporations. In such funds the county has no interest, and to require it to reimburse the treasurer for such funds would render it necessary to tax the people of the county generally, on account of funds used in some particular township or municipal corporation for purely local purposes. This would be unjust, and to justify us in holding that the legislature intended such an injustice, the language of the statute should be such as to leave no reasonable doubt. The court erred in including in its judgment money paid over to the townships in various townships in [defendant] county. [Another statute] expressly provides that the treasurer shall be reimbursed out of the state treasury, and not out of the county treasury. It is true it devolves upon the board of commissioners to make the proper finding and order, but this is not a proceeding seeking a finding and order of the kind required, but is an action to recover a money judgment. The law does not contemplate a money judgment against the county for money erroneously paid into the state treasury."

[1] School District 2 of Township of Buckeye *v.* Clark, (1892) 90 Mich. 435.

against the town a judgment rendered in that court for interest upon certain bonds the town had issued to aid in the construction of a railroad.[1] One of the defenses or grounds upon which it was claimed by the respondent that a *mandamus* should not issue in this case was that the judgment was rendered for interest upon certain bonds issued by the town to aid in the construction of a railroad; and that both the Supreme Court of the state of

[1] United States ex rel. Portsmouth Savings Bank *v.* Board of Auditors of the Town of Ottawa, (1886) 28 Fed. Rep. 407. As to the duty of town boards of auditors in such matters, in his opinion, BLODGETT, J., said: "The statutes of this state [Illinois] provide that judgment against towns are a town charge, and when collected shall be paid to the person or persons to whom the same shall have been adjudged. Haines Tps. (ed. 1833) 66. The town board of auditors have no discretion to refuse to audit a valid judgment against the town, and have no power to pass in review upon a judgment recovered against the town upon the solemn adjudication of a court. Town of Lyons *v.* Cooledge, 89 Ill. 529; Supervisors *v.* U. S., 4 Wall. 444; U. S. *v.* New Orleans, 98 U. S. 381; City of Cairo *v.* Campbell, (Ill.) 5 N. E. Rep. 114." There was a contention that the case was affected by the General Statutes of Illinois, requiring the issue of an execution upon a judgment within seven years. It was said upon this point: "On the rendition of this judgment against the town it became the duty of the town board of auditors to audit it, and provide for its payment. No execution was needed, and the issue of an execution could add nothing to the plaintiff's right; and this right to have the judgment audited, and a tax levied and collected for its payment, seems to me to be a continuing right, in no way dependent on the question as to the lien of the judgment, whether an execution could issue upon it. The issue of an execution could do the plaintiff no good, as he could make no levy upon the property of the town, and collect nothing by it; and, hence, the plaintiff's right to enforce the payment in the only way in which a judgment can be enforced against a municipality, that is, by writ of *mandamus*, is in no way impaired by the lapse of seven years. The plaintiff, if this judgment were revived by a *scire facias*, would acquire no additional right against the town to that which he now has; and the judgment, if revived, would have no greater legal or moral force than it now has. I am, therefore, of opinion that the *mandamus* will lie to compel the auditing of this judgment, and the levy and collection of a tax for its payment, although more than seven years have elapsed since its rendition." In another part of the opinion it was said as to such judgments: "It has been repeatedly held by the Supreme Court of this State [Illinois] that a judgment against a municipal corporation cannot be collected by execution, and under the township organization laws of this state the townships are *quasi* municipal corporations for governmental purposes, and the property held by them is held for public purposes, which would seem to bring them within the same rule." Citing art. 9, § 12, Const. Ill.; City of Chicago *v.* Hasley, 25 Ill. 595; Town of Odell *v.* Schroeder, 58 Ill. 353; City of Paris *v.* Cracraft, 85 Ill. 294; Norton *v.* Peck, 3 Wis. 714; Rumford *v.* Wood, 13 Mass. 193; Drake *v.* Phillips, 40 Ill. 388.

Illinois and the Supreme Court of the United States had decided that such bonds were void for want of power in the town to issue the same. As to this objection Blodgett, J., said: " * * * It seems to me sufficient to say that the questions as to the validity of this indebtedness were all raised in this suit, and this court held that the indebtedness was valid, and rendered judgment against the town. This judgment was never appealed from, and remains unreversed, and no error has been adjudged in reference to this particular case. Decisions of the Supreme Court in other suits on the same series of bonds or indebtedness do not reverse or affect this judgment. It is true that under the rulings of the Supreme Court as to the law under which these bonds were issued, it may be said that this court erred in rendering this judgment, but this judgment was conclusive until reversed for such error by an appellate court. * * * Nor do I think there is any force in the argument * * * that this judgment cannot be enforced by *mandamus*, because the town had no authority to create the debt in question, and, therefore, have no authority to levy a tax for its payment; because when the judgment was rendered against the town it became a charge against it as completely as if it had been rendered for a debt which the town had full authority to contract. After a judgment has been rendered by a court of competent jurisdiction, even if the court erred in so rendering it, the judgment is binding upon the town until it is reversed by the appellate court, and the board of town authorities have no discretion, but must audit it as a town charge. Town of Lyons *v.* Cooledge, 89 Ill. 529. * * * The moment a judgment is pronounced that moment it becomes the duty of the town to pay it, and of the town officers to see that it is paid by taking steps for the levying and collecting of a sufficient tax; and the town officers cannot, after judgment, be heard to question the validity of the indebtedness for which the judgment was rendered." [1]

§ 380. The right of a de facto county treasurer to salary.— One, in a contest as to whether he was elected county treasurer of a Nebraska county, a decision being rendered against him, appealed to the District Court. In the meantime, pending the

[1] United States ex rel. Portsmouth Town of Ottawa, (1886) 28 Fed. Rep. Sav. Bank *v.* Board of Auditors of 407, 410.

appeal, his opponent in the contest went into possession of the office, and was paid the salary and fees during his incumbency by the county authorities. This opponent was finally, by writ of ouster, removed, and the one held to have been rightfully elected placed in office. On the expiration of his term the latter retained, in settlement with his successor, a sum of money equal to what his emoluments during the period for which his opponent was in possession of the office would have amounted to. The Supreme Court of Nebraska, on a petition for a writ of *mandamus* to compel him to pay this amount to his successor as county treasurer, ordered the writ to issue, holding that the county was protected in the payment of the emoluments of the office to the *de facto* officer by its board of commissioners for the time he was in possession of the office.[1]

[1] State ex rel. Greeley County *v.* Milne, (1893) 36 Neb. 301. The court said: "The question presented for determination is whether a *de jure* county officer can recover the salary or compensation which attaches to the office while it is in the possession of an officer *de facto*, who, before any judgment of ouster has been rendered against him, has been paid by the county the salary of the office. The question has never been passed upon by this court, and the decisions in other states are conflicting and irreconcilable. In establishing a precedent we shall adopt the rule which to us seems the best supported by reason and in harmony with judicial principles. The doctrine that the acts of an officer *de facto* are void so far as they affect third parties and the public, is so familiar and well settled that no citation of authorities is necessary to show it. The acts of such officer are sustained upon the ground that to question them would devolve upon every person transacting business with the officer the duty of determining for himself, at his peril, the right of the incumbent to the office he holds. Third parties assume no such risk. They are not bound to know that the person exercising the functions of a public office under color of authority is rightfully in possession of the office, but are warranted in recognizing him as the legal and valid officer, and are justified in dealing with him as such. If a person pays to a *de facto* officer the fees allowed by law for his services, he is protected, and will not be compelled to pay them the second time to the officer *de jure*. We think the same principle should govern in a case like the one at bar. Cashman was the *de facto* county treasurer of Greeley county, and performed the duties of the office under color of title from January 9, 1890, to October 28, 1891, during which time he received all the emoluments which attached to the office. He took possession of the office in good faith by virtue of the decision in his favor of the contest court, and continued to occupy the office until the respondent was declared to be entitled to the same by virtue of a judgment of ouster obtained by him against Cashman on the final determination of the appeal in the contest case by the District Court. The county board, in settling with Cashman, and allowing him the fees and salary provided by law for the

§ 381. Payments to city official in excess of salary may be recovered of him.— A city in the state of Washington, as it was empowered to do, fixed by ordinance the salary of members of its council. Afterwards the council ordered and there was paid to a member of the council additional sums of money in excess of the salary named for services. The city brought its action against him to recover the money which it held was paid him illegally and without authority. The Supreme Court of the state held that such an order by the council was unauthorized and that the city was entitled to recover the money thus improperly paid to this member of the council.[1] The principle of law that

period during which he performed the duties of the office, the same having been made before the respondent came into possession, had no right to rely upon the apparent title of Cashman, and to treat him as an officer *de jure*. The board was justified in allowing him the emoluments of the office upon that assumption, and the county cannot be compelled to pay them again. We are aware that courts of high authority have sustained the contrary doctrine, but the decided preponderance of authorities support the conclusion we have reached." The court cited: Steubenville *v.* Culp, 38 Ohio St. 18; Wayne County *v.* Benoit, 20 Mich. 176; Parker *v.* Supervisors of Dakota County, 4 Minn. 59; Dolan *v.* Mayor, 68 N. Y. 274; McVeany *v.* Mayor, 80 N. Y. 185; Terhune *v.* Mayor, 88 N. Y. 247; Hagan *v.* City of Brooklyn, 126 N. Y. 643; Saline County *v.* Anderson, 20 Kans. 298; Gorman *v.* Boise County, 1 Idaho, 655; Shaw *v.* County of Pima, (Ariz.) 18 Pac. Rep. 273; State *v.* Clark, 52 Mo. 508; Westberg *v.* City of Kansas, 64 Mo. 493; Shannon *v.* Portsmouth, 54 N. H. 183.

[1] City of Tacoma *v.* Lillis, (1892) 4 Wash. St. 797. The court said: "It may be stated as a general legal proposition that valid ordinances have the force of laws, and are as binding upon the inhabitants of a municipality as are the statutes of the state upon its citizens generally. 1 Dill. Mun. Corp. (4th ed.) § 308; Milne *v.* Davidson, 5 Mart. (N. S.) 409. When the city council passed that ordinance they established the law upon the subject of salary of councilmen, and they were as firmly bound by its provisions as if it had been a law passed by the legislature of the territory. And this being so they had thereafter no right or authority to pay themselves any other or greater sum for services rendered in their official capacity than that specified in the ordinance so long as it remained in force. But it is argued * * * for appellant that the city council were not prohibited, either by law or by the organic act of the territory, from changing an officer's salary or fees at any time they saw proper to do so, either by ordinance or resolution, and that they did so in this case. Undoubtedly the law-making body of the corporation had, prior to the taking effect of the State Constitution, the right and power to increase or diminish the salary of appellant. The right to pass ordinances implies the right to repeal them; but in this instance we nowhere find in the record that the council ever attempted to change or appeal [repeal?] the ordinance fixing the salary of its members. It can hardly be said that the receiving and paying of claims for services alleged to have

money voluntarily paid, with full knowledge of the facts and without fraud or duress, could not be recovered from him, which was invoked by the one receiving the money in excess of his salary, the court considered inapplicable to the case.[1]

§ 382. Compelling a ministerial officer to distribute the fund in his hands.— The law as to the proper proceeding against a ministerial officer holding a fund in his hands to compel a proper distribution of it, has been declared in a case before the Supreme Court of Indiana; a petition for a writ of *mandamus* to compel a public officer here, the drainage commissioner, to pay the petitioner a sum due him on the performance of his contract in construction of a public ditch, under the laws of that state as to drainage, etc. Elliott, J., for the court, said: "The case is that of a ministerial officer with money in his hands which it is his duty to pay to the party entitled to it under the law. The fund in the appellant's hands was derived from an assessment for

been rendered effected a repeal or even a modification of the ordinance, which, as we have already intimated, was the measure of the city's liability to appellant as well as of his rights to compensation."

[1] City of Tacoma *v.* Lillis, (1892) 4 Wash. St. 797. The court said: "Appellant was the agent of the city and was intrusted with the care and management of its funds, and if he appropriated any of such funds to his own use, contrary to law, he is liable therefor as such agent, although he may have done it under a claim of right and with no dishonest motive. Another reason why the doctrine contended for by counsel ought not to be held applicable to cases like the one now under consideration is that it would enable a municipal council to violate with impunity a plain provision of the Constitution. This question was before the court in Weeks *v.* Texarkana, 50 Ark. 81; s. c., 6 S. W. Rep. 504. The case was this: Weeks was city recorder, and his salary had been reduced. He claimed to be entitled to the salary as originally fixed, and sued the city to recover it. The city claimed a set-off on account of overpayment after the ordinance reducing his salary took effect. The trial court held that the money, having been voluntarily paid, could not be recovered back. The Supreme Court ruled otherwise, using this language: 'But the court below seems to have considered that the town, having voluntarily paid Weeks this salary under no misapprehension of the facts, could not recover it back. However true this may be as a general proposition, it ought not to be extended to cases where the officer so wrongfully receiving payment was a member of the council or board which ordered such payment. This would enable every municipal body to evade the salutary restraints imposed by the statute. They might vote themselves extravagant salaries after their induction into office, and when they had received the money might set the municipality at defiance.' See, also, Petersburgh *v.* Mappin, 14 Ill. 193; East Nissouri *v.* Horseman, 16 U. C. Q. B. 582; Daniels *v.* Burford, 10 U. C. Q. B. 478."

a specific purpose, and the relator, as the contractor, having constructed the ditch for which the assessments were levied, has a right to compel the appellant to distribute to him the fund as the law directs. The case before us falls within the rule that a ministerial officer who has in his hands a specific fund may be compelled by *mandamus* to make lawful distribution of the fund.[1] In this instance there is no question of contract liability; the question is as to the duty of the appellant to distribute to the relator the specific fund derived from the assessments levied to pay for the construction of the public ditch. The officer has no right to the specific fund, and he is liable, if at all, because he violates his duty in withholding the specific fund from the party entitled to it. He is not liable, upon the facts stated in the petition, to an action for a breach of contract duty, but he is liable, if liable at all, because he has violated a duty imposed upon him by law. Such cases as State ex rel. *v.* Trustees, 114 Ind. 389, are not relevant to the point here in dispute, since the liability of the appellant is not upon contract, but his liability arises out of a failure to distribute a specific fund in his hands as the law requires. Confessing, as the appellant does, by his demurrer, that he has the specific fund in his hands, and that the relator is entitled to it under the law, he cannot successfully urge as a reason for withholding the fund, that the landowners who paid the assessments which created the fund are not parties to the action. He has the fund — the assessments have been paid — and it is his duty, upon proper demand, to pay the relator the money due him out of the specific fund. There is no merit in his contention that the landowners should be parties, for nothing remains for him to do except to make proper distribution of the specific fund realized from the assessments."[2] As to the pleadings in the case, it was said: "There is a fatal defect in the petition and alternative writ. No demand is shown, and in such a case as this a demand is essential. The presumption is that an officer will do his duty upon request, and to put him in the wrong a demand is essential. Jackson School Tp. *v.* Farlow, 75 Ind. 118. A claimant of a fund cannot maintain

[1] Citing Portland Stone Ware Co. *v.* Taylor, (R. I.) 19 Atl. Rep. 1086; Board, etc., *v.* People ex rel., 24 Ill. App. 410; Case *v.* Wresler, 4 Ohio St. 561; Illinois State Hospital *v.* Higgins, 15 Ill. 185; United States ex rel. *v.* Board, etc., 28 Fed. Rep. 407; State ex rel. *v.* Board, etc., 4 Ind. 495.

[2] Ingerman, Drainage Commissioner, *v.* State ex rel. Conroy, (1891) 128 Ind. 225, 227, 228.

such an action as this without first demanding payment of his claim. The authorities are well agreed that where the duty is owing to a private person and not to the public, a demand must be alleged with precision in the petition for a writ of such an extraordinary character as that invoked by the relator."[1]

§ 383. County warrants — their issue and validity — rules governing. — A county in Illinois issued various county warrants upon its treasurer in favor of different parties for different considerations, which were assigned to an individual by the original payees; the assignee, in an action against the county, had judgment from the court, the trial being had upon a stipulation of facts. The appellate court, on appeal, reversed this judgment, and held that the warrants were invalid because the terms of the statute authorizing the issue of county warrants had been disregarded.[2] It was further held that neither the assignor nor the

[1] Citing State ex rel. *v.* Slick, 86 Ind. 501; Oroville, etc., R. R. Co. *v.* Supervisors, etc., 37 Cal. 354; Board, etc., *v.* Arrghi, 51 Miss. 667; State ex rel. *v.* Schaack, 28 Minn. 358; State ex rel. *v.* Davis, 17 Minn. 429; Lee County *v.* State ex rel., 36 Ark. 276; citations in 4 Am. & Eng. Ency. of Law, 106.

[2] County of Cook *v.* Lowe, (1887) 23 Ill. App. 649. The court referred to the cases, City of Springfield *v.* Edwards, 84 Ill. 626, and Chicago *v.* Shober & C. Lithographing Co., 6 Ill. App. 560, as to the rules established in these cases, and then said: "The statute in a guarded and precise manner prescribes the conditions under which warrants payable on demand, as were those on which this suit was brought, may be issued, and inhibits such issue except under such conditions, and the stipulated facts show that the warrants sued on were issued when the conditions required by the statute did not exist. The statute directs that such warrants shall be drawn and issued 'only when at the time of the drawing and issuing of such warrants, there shall be sufficient money in the appropriate fund in the treasury to pay them,' and the stipulation admits 'that at the time of the drawing and issuing of such warrants on the county treasurer of said county there was not sufficient money in the appropriate fund in said treasury to pay them.' It was suggested in argument that the warrants were not drawn on any particular fund, but were made payable out of the treasury generally, and that there was no evidence that there was no money at all in the treasury. There is nothing in the attempted distinction. The admission that there was no money in the appropriate fund is equivalent to the statement that there was no money in the hands of the treasurer of the county liable to be drawn against by the order of the county board for the payment of the debt for which the warrants were issued. The warrants were drawn and issued without authority of law, and against the inhibition of the statute, and were, therefore, clearly invalid, and as instruments absolutely void, whether in the

assignee of the warrants could recover upon them, because they were invalid; further, that the assignee was not entitled to judgment in his favor on the void warrants, and, treating them as evidence of an assignment of the original account, he could not recover in the action as brought in his own name.[1] In an action against the board of commissioners of a Kansas county upon county warrants as to farm property, issued by the board in payment of lands purchased for a poor farm, a question was made as to whether the assessment of taxes under the statute of that state relating to the subject had been properly authorized by a vote of the people. The direct question was whether it required "a majority of all the votes cast at a poll opened for that purpose." It was held by the United States Circuit Court for the district of Kansas that it was sufficient if the proposition received a majority of all the votes cast on that particular proposition, and that it was not necessary that it should receive a majority of all the votes cast at

hands of the person to whom they were made payable, or in the hands of an assignee."

[1] County of Cook *v.* Lowe, (1887) 23 Ill. App. 649. As to the effect of the assignment of these warrants it was said by the court: "A void instrument cannot be given validity by assigning it, and while such assignment may not be entirely without operation between the parties to it, yet the void instrument can never itself be made the basis of a recovery at law or in equity. The assignment may be evidence in equity of an intention to assign the claim for which the warrant was issued. As was said in Goldsmith *v.* Stewart, 45 Ark. 153, 'although an instrument may be void, it does not follow that an assignment of it is wholly inoperative in equity. If it is supposed by the parties to represent a claim for money, and if assigned for value it will raise an equity in the assignee, not to recover on the instrument itself, but to stand in the shoes of the assignor with regard to the original claim for which it was substituted. It is evidentiary of the equity. While it is true a party to whom one of these warrants was issued, if he stood in the place of appellee as plaintiff in this suit, could have recovered the value of the services rendered or material furnished by him to the county under the common counts, his recovery would not be upon the void instrument, but on the original claim or account for which the warrant was issued. It does not at all follow, however, that the assignee can so recover; the assignment of the warrant can at best be treated as an equitable assignment of the account, and he could not sue at law upon such assigned account in his own name, but must sue, if at all, in the name of the assignor for his use. What was said in The People *v.* Johnson, 100 Ill. 537, as to county orders being transferred by indorsement, and as to the right of the assignee to sue in his own name, had reference to valid warrants. By usage and for business convenience, the assignee of such an order may sue in his own name, but is subject to all the equities and defenses which exist against the original payee. But here in law appellee took nothing whatever by the assignment of the warrant."

the election.[1] The United States Circuit Court for the eastern district of Missouri has ruled as to county warrants issued under the laws of that state, as follows: *Mandamus* having been granted requiring the County Court to draw warrants in favor of relators, payable out of "the general funds of the county," the warrants being drawn accordingly, but at relator's request, other warrants being drawn on another fund in lieu of the warrants already drawn, and issued to the relators, the latter warrants were held to have been issued pursuant to the writ of *mandamus*. That under the general statutes of Missouri, providing that county warrants are receivable in discharge of "any county or city revenue, license, tax, assessment, fine, penalty or forfeiture," such warrants were receivable in payment of a special tax levied for payment of county bonds, though the priority in which such warrants were required by law to be paid was thereby defeated. That the statute of Missouri, providing that several warrants may be issued for one claim against a county, instead of issuing a single warrant, as was provided by the existing law, did not so change the administration of county finances as to impair the remedy for the collection of outstanding warrants. And where warrants had been received from an assignee thereof in payment of taxes, and such payment had been approved by the County Court on the settlement of the accounts of the county treasurer, such payment would be considered sufficient, though this assignment was not in the form required by law.[2]

§ 384. Statute of Limitations not applicable to county warrants.— In a case involving the question of whether the Statute of Limitations can be pleaded successfully against county warrants, the Supreme Court of Nebraska has said, as to the holders of such: "Whoever deals with a county and takes in payment of his demand a warrant of the character of these, no

[1] Armour Bros. Bkg. Co. *v.* Board of County Commis. of Finney County, (1890) 41 Fed. Rep. 321, supported by Commissioners *v.* Winkley, 29 Kans. 36; State *v.* Echols, 20 Pac. Rep. 523; Cass Co. *v.* Johnston, 95 U. S. 369; Walker *v.* Oswald, 11 Atl. Rep. 711; Gillespie *v.* Palmer, 20 Wis. 544; Sanford *v.* Prentice, 28 Wis. 358.

[2] United States ex rel. Huidekoper *v.* Macon County Court, (1891) 45 Fed. Rep. 400. See State *v.* Winterbottom, 123 U. S. 215; s. c., 8 Sup. Ct. Rep. 98.

time of payment being fixed, does so under an implied agreement that if there be no funds in the treasury out of which it can be satisfied, he will wait until the money can be raised in the ordinary mode of collecting such revenues. He is presumed to act with reference to the actual condition and the laws regulating and controlling the business of the county. He cannot be permitted, immediately upon the receipt of such warrant, to resort to the county to enforce payment by judgment and execution, without regard to the condition of the treasury at the time, or the laws by which the revenues are raised and disbursed." They held, therefore, that the Statute of Limitations did not apply to cases of such claims against counties; that whenever it can be shown that the funds have been collected out of which the warrants can be paid, or sufficient time has been given to do so in the mode pointed out on the statute, payment of them may be demanded, and, if refused, legally coerced.[1]

[1] Brewer *v.* Otoe County, 1 Neb. 373. The court said: "But these warrants do not, nor was it the intention of the legislature that they should, fall within the operation of this act. * * * Nor can any action rightfully be brought on such warrant until the fund is raised, or, at least, sufficient time has elapsed to enable the county to levy and collect it in the mode prescribed in the revenue laws. That the legislature never intended that county warrants should be affected by the limitation act before referred to is evident, I think, from the whole course of legislation respecting them. As late as the 12th of February, 1866, it was enacted that 'all debts heretofore incurred by the county commissioners of any county, acting in good faith, and duly recorded at the time on their books, shall be deemed valid, and the county shall be held liable for the same.' Chap. 5, § 1, Rev. Stat. Neb."

As to "Fiscal Management — Public Corporations" see further, chapter 3, "Power of Agents and Officers — Public Corporations."

CHAPTER XVII.

FISCAL MANAGEMENT — PRIVATE CORPORATIONS.

§ 385. Execution of contracts by corporations.
386. What would be conclusive of the execution of a contract.
387. Declaring dividends.
388. Rules as to declaring dividends by a mining corporation.
389. Borrowing money to pay dividends.
§ 390. Rescinding a declaration of dividend.
391. Contracts within and outside the power of private corporations.
392. Rules as to estoppel to plead that contracts are ultra vires.

§ 385. Execution of contracts by corporations — rules governing. — A valid written contract may be made by a private corporation in Iowa without the use of a seal, even though such contract be one out of the ordinary course of the business of the corporation.[1] There is a statute of North Carolina which prescribes that "Every contract of every corporation, by which a liability may be incurred by the company exceeding one hundred dollars, shall be in writing, and either under the common seal of

[1] Muscatine Water Co. *v.* Muscatine Lumber Co., (1892) 85 Iowa, 112. The court said: "Section 2112 of the Code contains the following: 'The use of private seals in written contracts, except the seals of corporations, is abolished.' It is argued from this that the use of private seals by corporations is governed by the rules of the common law, and that such seals must be affixed to all contracts not covering the scope of the ordinary, every-day functions of the corporations. That is not the law of this state. On the contrary, it was said in Merrick *v.* Plank Road Co., 11 Iowa, 76, that the doctrine is now well settled that corporations of all kinds may be bound by contracts not under their seals. They may make a binding contract in writing without using the seal, and so they may be held as verbal contracts; and as they may make, so they may ratify and adopt as their own, and without the use of the seal, that which has been done by another, or an officer out of the usual line of his duties." As to use of seal in corporation contracts, see Derringer's Admr. *v.* Derringer's Admr., 5 Houst. 416; Bancroft *v.* Will. Conf. Academy, 5 Houst. 577; Vandegrift *v.* Delaware R. R. Co., 2 Houst. 287. What is *prima facie* evidence that a seal was properly affixed to an instrument executed by a corporation, see Conine *v.* J. & B. R. R. Co., 3 Houst. 288. As to presumptions as to seals to contracts of corporations, see Blackshire *v.* Iowa Homestead Co., 39 Iowa, 624; Chicago, Burlington & Quincy R. R. Co. *v.* Lewis, 53 Iowa, 101; Morse *v.* Beale, 68 Iowa, 463; s. c., 27 N. W. Rep. 461; Goodnow *v.* Oakley, 68 Iowa, 25; s. c., 25 N. W. Rep. 912

the corporation or signed by some officer of the company authorized thereto." The Supreme Court of that state have said of this statute: "This provision is important and not merely directory. Its purpose is to protect corporations against the hasty or fraudulent acts and practices of their incautious or faithless officers and agents, and as well those persons who deal with them in respect to contracts involving pecuniary liability of importance. They must necessarily act and contract by and through their officers and agents, and it is wise and salutary to protect them and those who deal with them in the way thus provided. Such contracts must be in writing and under the common seal of the corporation, or signed by some one of its officers authorized thereto. It is not sufficient to simply recognize by such officer or agent a merely verbal contract to give it efficiency. It must be done in writing, and in such way as to give evidence of the nature, purpose and substance of the contract. Otherwise, the statute would be practically nugatory. * * * The statute refers to executory contracts which create liabilities and obligations of the corporation — not to cases where they have received and availed themselves of property sold and actually delivered to them."[1] Upon an issue as to whether the execution of a mortgage by the president and secretary of a corporation was authorized by a board of its directors, in whom the control and management of its affairs was vested, parol evidence is admissible to prove the action of the board, when the record of the meeting fails to state it.[2] In the same case Caldwell, J., said: "The omission to attach the corporate seal to the mortgages is not fatal to their validity in equity. The companies admit their execution and assert their validity. The owners of all the stock of the companies assert their validity. They were given for debts actually due from the companies to the banks. The officers and stockholders of the milling companies had no personal interest in the debts secured by the mortgages. No part of the money belonged to them, nor were any of them sureties for its payment. On this state of facts, it is not necessary to inquire whether these mortgages are legal and sufficient securities at law against the

[1] Curtis *v.* Piedmont Lumber & Mining Co., (1891) 109 N. C. 401, 403, 404.

[2] Allis *v.* Jones, (1891) 45 Fed. Rep. 148, 149; citing U. S. Bank *v.* Dandridge, 12 Wheat. 72; Mining Co. *v.* Anglo-Californian Bank, 104 U. S. 192; Eureka Co. *v.* Bailey Co., 11 Wall. 488; Whart. Ev. § 663; Davidson *v.* Bridgeport, 8 Conn. 472; Ratcliff *v.* Teters, 27 Ohio St. 66; Taymouth *v.* Koehler, 35 Mich. 22; Bank *v.* Kortright, 22 Wend. 348.

general creditors of the companies. They are undoubtedly good in equity.[1] "In Koehler *v.* Iron Co., 2 Black, 716," said the court, "the court declined to treat a mortgage of a corporation not under seal as good in equity, because it was declared on as a legal, and not an equitable, mortgage." To obviate this objection the banks in this case were granted leave to amend their cross-bills by adding a special prayer, to the effect that, if the court should hold them ineffectual as legal mortgages, they may be held and treated as equitable mortgages.[2] In a late Maryland case, an action upon a contract to pay royalties executed under seal by a manufacturing corporation, the plaintiff, for the purpose of proving the execution of the agreement, offered to prove that all the persons whose names were signed thereto were stockholders of the company, and holders of all the capital stock thereof; that the board of directors consisted of three, the plaintiff, who was the president of the company, and two other parties, one of whom was its secretary, treasurer, and custodian of its corporate seal; that at a meeting of the directors the contract was signed by those two, on behalf of the company; that by authority of the board of directors at this meeting the corporate seal of the company was there and then affixed to the contract by the secretary, and that the impression of the seal used on the contract was the corporate seal of the company, adopted and used as such by it at that time; that the directors usually held their meetings for the transaction of the ordinary business of the company without making or keeping any minutes of their proceedings; and that no minutes of the meeting at which this contract was signed and sealed as aforesaid were made or kept by the company or any of its agents or officers. Upon objection the evidence was not allowed to go the jury. The Maryland Court of Appeals held the ruling to be erroneous.[3] Miller, J., for the court said: "In our opinion it was competent for this corporation to bind itself by this contract under its corporate seal, and that the fact that it did so may be proved otherwise than by a formal resolution in writing of its board of direct-

[1] Allis *v.* Jones, (1891) 45 Fed. Rep. 148, 149, 150; citing Love *v.* Mining Co., 32 Cal. 639; Miller *v.* Railroad Co., 36 Vt. 452, and others.

[2] Allis *v.* Jones, (1891) 45 Fed. Rep. 148, 150.

[3] Zihlman *v.* Cumberland Glass Co., (1891) 74 Md. 303, 308, 309; s. c., 22 Atl. Rep. 271.

ors spread upon its minutes. Sealing was the essential part of the execution of this agreement by the corporation, and the essential facts to be proved are that the seal affixed to this instrument was in fact the corporate seal of the company, and that it was duly and properly affixed thereto. The offer to prove this by parol evidence is clear and satisfactory. It is that the seal affixed was the corporate seal of the company then used and adopted by it as such; that it was affixed in the presence and by the authority of the full board of directors by their secretary, who was its custodian; and that it was also signed by all the then stockholders of the corporation, and that it was signed by the [directors outside of plaintiff] for and on behalf of the company. It is hardly possible to conceive of more complete proof of the execution of a sealed instrument by a corporation than this, provided such proof may be made by parol testimony. We have already said in our opinion such testimony may be used for that purpose. The old doctrine that a corporation can bind itself by contract only by a formal resolution *in writing*, adopted by its board of directors, has long since been repudiated by the modern decisions, both in England and in this country, and no authority on that subject need be cited. We cannot distinguish this case from that of Susquehanna Bridge & Bank Co. *v.* General Ins. Co., 3 Md. 305, where the execution of a mortgage by the appellant corporation was proved by parol testimony less strong than that embraced in this offer, and where the mortgage was held valid and binding upon the corporation." In an action upon the promissory notes of a corporation it has been held in the federal court for the eastern district of Pennsylvania that an affidavit of defense that "the notes sued on do not purport on their face to have been signed by two managers of the defendant company," and that "there is no averment that the persons who signed them are or were" such managers, was not sustained where the notes were signed by the "chairman" and the "treasurer" of the corporation, inasmuch as the statute of Pennsylvania provides that the "chairman" and the "treasurer" shall be managers. It was also held that the defense that the payee of the negotiable notes, which were given in Pennsylvania, was a foreign corporation which had failed to comply with the conditions prescribed by statute to entitle it to do business in Pennsylvania, and that the contract under which the notes were given was in violation

of that statute, was not available against one who paid value for the notes before maturity, and had no notice of the illegality infecting them.[1] The promissory note sued upon here recited in the body of it, "we promise to pay," but with nothing there to indicate to whom "we" referred. It bore upon its face, in the usual place of signing, the name "John Roach," beneath which was written "Treasurer," and had in addition the impression stamped upon it of a large circular corporate seal, around the upper edge of which appeared in print, "New York Skating Rink Construction Company," and in the center of it, "Incorporated 1884," so placed that the circumference passed through the final letter of "Roach" and the word "Treasurer." The Massachusetts Supreme Court held that the note was the note of the corporation.[2]

[1] City Bank of Hartford *v.* Press Co. (Limited), (1893) 56 Fed. Rep. 260. As to formalities of contracts, see Peterson *v.* Mille Lacs Lumber Co., (Minn.) 52 N. W. Rep. 1082; Ballard *v.* Carmichael, 83 Tex. 355; Shaffer *v.* Hahn, 111 N. C. 1; s. c., 15 S. E. Rep. 1033; Ruffner *v.* Coal Co., 36 W. Va. 244; Danville Seminary *v.* Mott, 136 Ill. 289; Cary-Halidy Lumber Co. *v.* Cain, (Miss.) 13 So. Rep. 239; Teitig *v.* Boesman, 12 Mont. 404; s. c., 31 Pac. Rep. 371. What is a signature for a corporation and what will bind it, see Dwyer *v.* Rathbone, Sard & Co., 5 N. Y. Supp. 505; Davis *v.* Gemmell, 70 Md. 376; s. c., 17 Atl. Rep. 259; Saltmarsh *v.* Spaulding, 147 Mass. 224; Catlett *v.* Starr, 70 Tex. 485; Fidelity Ins., Trust & Safe Deposit Co. *v.* Shenandoah Valley R. Co., 32 W. Va. 244; s. c., 9 S. E. Rep. 180; First Nat. Bank *v.* Salem Capital Flour Mills Co., 39 Fed. Rep. 89. Agents and officers executing notes. Gane *v.* Loemo Printing Co., 46 Ill. App. 456; In re Millward-Cliff Cracker Co., 161 Pa. St. 157; s. c., 28 Atl. Rep. 1077; Elwell *v.* Puget Sound, etc., R. Co., 7 Wash. 487; s. c., 35 Pac. Rep. 376; Edwards *v.* Carson Water Co., 21 Nev. 469; s. c., 34 Pac. Rep. 381.

[2] Miller *v.* Roach, (1889) 150 Mass. 140. Knowlton, J., for the court, said: "The case is peculiar in the use of the corporate seal. If the words which appear on the face of the seal had been written in their place on the note and had been followed by the words, 'John Roach, Treasurer,' there would have been no doubt that they were so written as the signature of the corporation appended by its treasurer. Draper *v.* Massachusetts Steam Heating Co., 5 Allen, 338. That mode of signing is common among corporations. And if the words had been affixed in print by a stamp designed to be used in signing the corporate name, and a blank space had been left in which the treasurer's name was afterwards inserted by him in his own handwriting, the result would have been the same. We think it makes no difference that the name of the corporation impressed upon the paper was so impressed by the corporate seal, which is ordinarily used in connection with a corporate act of signing. We are of opinion that the paper should be treated as a promissory note signed with the signature of the corporation affixed by its treasurer, who, for convenience in affixing it, used a stamp,

§ 386. What would be conclusive of the execution of a contract.— The facts disclosed in this case showed a contract made by the defendant, a manufacturing corporation of Illinois, with the plaintiffs, who were advertising agents, for placing certain advertisements of the corporation. In an action brought by the advertising agents against the corporation it was proposed to place in evidence a letter from the corporation offering a compromise, which was rejected. The United States Circuit Court of Appeals for the seventh circuit held that the rejection of the testimony was error; that the execution of the contract upon which the suit was based being denied by the defendant, the letter offering to compromise the claim and making an express recognition of the contract, was admissible in evidence as an admission of the execution of the contract.[1]

§ 387. Declaring dividends.—The declaring of dividends must ordinarily be left to the sound discretion of boards of directors. Whether a corporation can safely make a dividend involves the exercise of knowledge and judgment, and the power of decid-

except in that part which contained for verification his own name and official designation." See Mann *v.* Chandler, 9 Mass. 335; Fuller *v.* Hooper, 3 Gray, 334; Carpenter *v.* Farnsworth, 106 Mass. 561; Chipman *v.* Foster, 119 Mass. 189.

[1] Scofield *v.* Parlin & Orendorff Co., (1894) 61 Fed. Rep. 804. WOODS, Circuit Judge, said: "This letter, while not admissible to prove the offer of compromise, was admissible to show an independent statement or admission of fact pertinent to the question in issue. Of the authenticity of these letters and the contract transmitted with one of them, the circumstances in proof, the regular transmission by mail, the letter heads and envelopes, and the contents of the letters themselves, leave no reasonable doubt. They should have gone to the jury, and in the absence of contrary evidence should have been accepted as conclusive of the execution of the contract by the defendant. The ruling of the court to the contrary, and presumably the sworn denial of the execution of the contract, proceeded upon the theory that in order to bind the corporation, a contract must be shown to have been executed or authorized by a formal corporate act, such as an order or resolution of a board of directors. But the business of modern mercantile and manufacturing corporations is not always or even generally conducted in that way, but is committed to agents and managers, whose powers are limited practically only to the lines of business for the prosecution of which the corporations were formed. It follows that correspondence conducted by these agents and contracts made by them in the name of the principal in the due and ordinary course of business, must be admissible in evidence as if the parties were natural persons. If a document offered against a corporation is not genuine, or its execution unauthorized, the corporation will be able in most instances to show the

ing this question should not be taken from the directors and assumed by the courts, unless it clearly appears that the directors have mistaken their legal duties. To authorize the court to intervene and decree a dividend it ought, in the first place, to appear clearly that there are surplus profits to divide, and that such profits can be separated from the necessary working capital for the purpose of a dividend, without detriment to the interest of the stockholders and the prosperity of the business of the corporation. It ought to appear that there is no good reason for withholding a division of the surplus earnings among the stockholders, and that they are withheld from the will or caprice of the directors. If there is reasonable cause for withholding the dividend then it ought not to be decreed.[1] When a board of directors, made up of experienced business men, largely interested in the welfare of the corporation, familiar with all its affairs and influenced by no improper motive, declare that a dividend cannot be made without detriment to all concerned, then the court ought to proceed with great caution in declaring a dividend, and the facts proven upon the trial ought clearly to justify such action.[2]

§ 388. Rules as to declaring dividends by a mining corporation.— It was contended in a California case that in declaring

fact, while, on the other hand, if direct proof of formal or overt corporate action or authority were required of the opposite party, it would often be, indeed, it would be, in the power of the corporation to make it difficult or impossible."

[1] Hunter *v.* Roberts, Throp & Co. (a Corporation), 83 Mich. 63.

[2] Ibid. In which case the so-called "surplus profits" appearing to be tied up in bills receivable, etc., from which the current expenses, insurance, taxes, etc., were to be obtained, the court considered evidence that a sufficient sum could not be got out of it to make any considerable dividend without great sacrifice, and not then except at the necessity of driving the corporation to add largely to its indebtedness to obtain money to carry on its business and to pay its current expenses, and held it proper to refuse to decree a dividend. As to power of trustees of a manufacturing corporation to pay dividends in New York, see People ex rel. Edison General Electric Co. *v.* Barker, (1894) 141 N. Y. 251. As to what may be distributed as dividends on stock, see Gilkey *v.* Paine, (Me.) 14 Atl. Rep. 205. As to raising money by borrowing on bond and mortgage with a view to distributing surplus among stockholders, see Coquard *v.* St. Louis Cotton Compress Co., (Mo.) 7 S. W. Rep. 176. As to dividends, see In re James' Estate, 78 Hun, 121; s. c., 28 N. Y. Supp. 992; Ford *v.* Rubber Thread Co., 158 Mass. 84; Southwestern A. & I. T. Ry. Co. *v.* Martin, 57 Ark. 355. As to dividends upon preferred stock, see McLean *v.* Pittsburgh Plate-Glass Co., 159 Pa. St. 112; s. c., 28 Atl. Rep. 211; 33 W. N. C. 459.

dividends the directors of a mining corporation had violated the Civil Code, section 309, which provides that: "The directors of corporations must not make dividends, except from the surplus profits arising from the business thereof; nor must they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock. * * *" The contention was more fully stated in the opinion of the Supreme Court, in these words: "That the payment of the debts which the plaintiff assumed as part of the price of the property acquired from the Excelsior Water Company and the Pactolus Mining Company, as well as most of the items of expenditure for construction of tunnels, levees, ditches, etc., should be rated as current expenses and charged against its gross earnings, in order to ascertain the actual surplus profit of its business; while counsel for defendant contends, on the contrary, that the payments of the principal of its indebtedness, and its investments on what are called betterments of its property, should not be charged to current expenses of the business. As to the payment of the debts assumed by the plaintiff when it commenced business, or that incurred in making improvements, we do not understand its counsel to contend that it was necessary to pay them off before any dividends could be declared, but merely that whenever any part of its gross earnings was applied to the payment of a debt it was unlawful thereafter to replace such sum with the proceeds of a loan, and thereupon declare a dividend. The fact is not disclosed by the findings of the judge of the Supreme Court, but it seems to have been proved that in several instances money was borrowed by the plaintiff in order to pay dividends, and it seems to have happened in this way: The debts assumed by the plaintiff became due from time to time, and the permanent improvements on its property were made from time to time, so that large payments on both accounts were constantly occurring. Instead of borrowing money to make such payments at the time of making them, any money that happened to be on hand in the company's treasury was used, so far as it would go, and afterwards replaced by the proceeds of bonds, overdrafts or notes of the company, which, to the extent necessary, were used to pay regular dividends. It is in this course of proceeding that counsel claims that defendant was clearly guilty of a violation of section 309 of the Civil Code irrespective of any difference of views as to what are and what

are not current expenses justly chargeable against the gross receipts of a mining corporation in order to determine its net or surplus earnings or profits." The court held that the directors of a mining corporation which has become indebted either by acquiring its property incumbered with debt, or by making permanent improvements for the thorough and systematic working of the mines and other property, would not be guilty of an infraction of section 309 of the Civil Code of California merely because they declared and paid dividends out of the net proceeds of the mine without paying the whole of such debts. It was further held that if the directors have fairly and honestly applied towards the payment and extinguishment of the debts of the company, a share of the net earnings satisfactory to its creditors and reasonably proportioned to the amount of its indebtedness, the extent and permanence of its mine, or the rate at which it is being exhausted, they may properly and safely pay out the remainder in dividends, because such remainders may in such cases be justly regarded and treated as surplus profits of the business.[1]

[1] Excelsior Water & Mining Co. *v.* Pierce, (1891) 90 Cal. 131. *Arguendo*, the court said: "The term 'capital stock' has a double meaning, as applied to corporations. In one sense it is the sum mentioned in the articles of incorporation as the amount of the capital stock; in other words, it is the share capital, or nominal capital, and does not necessarily represent a corresponding amount of actual capital. In case of mining corporations it is always arbitrary and generally extravagant in amount. The capital stock referred to in the statute, however, is the actual property of the corporation contributed by the shareholders of the nominal capital. In this case the nominal or share capital of the plaintiff was $5,000,000. Its actual capital was its mining and other property (less the debt with which it was incumbered) received in exchange for the shares which it issued, and this actual capital was what it was forbidden to divide. This inhibition, however, did not extend to the net proceeds of its mining operations, for a mining corporation, like any other corporation organized for the purpose of utilizing a wasting property, a property that can be used only by consuming it, as a mine, a lease or a patent, is not deemed to have divided its capital merely because it has distributed the net proceeds of its mining operations, although the necessary result is that so much has been subtracted from the substance of its estate. Moraw. on Corporations, § 442; Lee *v.* Neuchatel Asphalte Co., L. R., 41 Ch. Div. 24. It may distribute its net earnings, although the value of its mine is thereby diminished. But it may not sell the mine, or any part of it, and distribute the proceeds. In this sense, and in this sense only, provisions of law similar to those of section 309 of our Civil Code have been held to apply to mining corporations. If the mine belonging to a mining corporation when it commences operations is free from debt, and furnished with all necessary openings and appliances for its convenient

§ 389. **Borrowing money to pay dividends.**— As to the borrowing of money to pay dividends on the part of a mining corporation, the Supreme Court of California has said: "We think there are circumstances which do justify it. A mining company is working its mines at a profit, but discovers that they can be worked to better advantage by constructing a new tunnel; that is to say, it will be wise economy to incur an expense of, say a hundred thousand dollars to construct such a tunnel; that it will in fact add more than that sum to the value of the property. Clearly, we think, the corporation would be justified in incurring a debt to that amount to carry out the object, and that it could go on declaring dividends after providing for the payment of the accruing interest, and for the gradual extinction of the principal of such debt. But suppose, instead of borrowing in advance to meet payments on the tunnel, it makes some of the payments out of the current profits of its mining operations — profits justly applicable, at its option, to the payments of dividends, but not presently needed to meet a declared dividend. Afterwards, it borrows money, no more than it might have borrowed originally

working, the problem of ascertaining the amount of its surplus profits from time to time would be very simple, and would consist in merely deducting the gross outlay from the gross receipts, and the balance, less a reasonable reserve to meet contingencies, would be the legitimate subject of a dividend. But when the mining property has been taken subject to a debt, or when, as a preliminary operation, it becomes necessary to incur a debt in running an expensive tunnel or sinking an expensive shaft, the problem becomes complicated. Must the whole of such debts be paid out of the first earnings before making a dividend, or must only a part be paid? and if so, what part? We do not think it would be necessary to pay, in the first place, the whole of such debts, but it would be necessary to pay accruing interest, and to provide a sinking fund sufficient to extinguish the principal before the mine was exhausted. There can be no doubt, we think, that this is a correct theory; but in case of a property of such uncertain, fluctuating and precarious value as a mine, it would undoubtedly be extremely difficult in most cases to practically apply it. Fortunately, however, the rights of the creditors to insist upon payment of their demands as they fall due, and the prudence of capitalists to whom the company would be compelled to resort for loans with which to extend the payment of its maturing indebtedness, would always furnish a due corrective for any disposition of the directors of a corporation to provide an inadequate fund for the extinguishment of its indebtedness, and it may be safely assumed that in the case supposed, unless the debts of the corporation were paid at a rate satisfactory to its creditors, they would put a stop to the payment of dividends by the means within their power."

on account of the tunnel, and, out of the money so borrowed, replenishes the fund applicable to dividends. In such a case, the result is precisely the same as if the money had been borrowed sooner, and the identical money borrowed paid out on the tunnel. Nothing has been accomplished beyond what the directors had a right to do, and surely the mode in which it has been done can make no difference. In fact, the transaction may be regarded as a temporary borrowing from the dividend fund of a sum necessary to meet an immediate demand, with the advantage to the corporation of keeping its money employed and saving in the payment of interest." [1]

§ 390. **Rescinding a declaration of dividend.**— A late case before the Supreme Court of Judicature of Massachusetts, it having been reported to that court from a judgment of the trial court for their consideration, disclosed the following facts: That on a certain date a dividend of twenty per cent upon the capital stock of a manufacturing corporation was ordered to be paid on a day fixed. On the same date the annual meeting of stockholders occurred and a new board of directors was elected, two only of the old board being re-elected. The new board on the same day, by resolution, rescinded the resolution directing a dividend of twenty per cent and declared a dividend of six per cent payable on the day fixed. It also appeared that no money was set aside or provided to pay the dividend declared of twenty per cent, but the company had ample means and facilities for paying it; that always before this time money had been provided to pay a dividend before it was declared; that money to pay the six per cent dividend was provided after the meeting and before it was to be paid by borrowing, and it was set aside and deposited in bank for the purpose; that checks were sent to all the stockholders,

[1] Excelsior Water & Mining Co. *v.* Pierce, (1891) 90 Cal. 131, 143, 144. The court cited Union Pacific R. R. Co. *v.* United States, 99 U. S. 420; Park *v.* Grant Locomotive Works, 40 N. J. Eq. 118, and Minot *v.* Paine, 99 Mass. 101; s. c., 96 Am. Dec. 705, as authority for the proposition that the apportionment of net earnings to the payment of cash dividends, stock dividends, increase of capital, reserve or contingent fund, or to provide for future obligations, is largely one of policy, intrusted to the discretion of the directors, which, when honestly and intelligently exercised, will not be lightly overruled. See, also, Stringer's Case, L. R., 4 Ch. App. 490; Williams *v.* Western Union Tel. Co., 93 N. Y. 162; Zellerbach *v.* Allenberg, (1893) 99 Cal. 57; s. c., 33 Pac. Rep. 786.

including the plaintiff in this case, for this six per cent dividend by the treasurer of the company; that he declined to accept the check and returned it to the treasurer. The twenty per cent dividend had been paid to no stockholder, and a majority of stockholders had accepted the six per cent dividend. The plaintiff, after demanding the payment of the twenty per cent dividend, which was refused, brought this action upon contract for money had and received to recover the same from the corporation. The trial judge declined to rule as requested by the corporation, that the directors elected at the annual meeting of stockholders had a right on that day to rescind the vote whereby the twenty per cent dividend was declared payable at a future day, and that the plaintiff could not recover, and ordered judgment for the plaintiff. The Supreme Court reversed this judgment.[1]

[1] Ford *v.* Easthampton Rubber Thread Co., (1893) 158 Mass. 84. The reasoning of FIELD, Ch. J., speaking for the court in support of this judgment was as follows: "It seems to be settled that, when a dividend has been fully declared, the corporation thereby manifests its intention that the amount of the dividend should be considered as having been separated from the other property of the corporation, and as having become the individual property of the stockholders, and that, therefore, when the dividend becomes payable according to the terms of the vote declaring it, each stockholder has a right to demand payment of the proportional part of the dividend which belongs to his shares of stock, and to sue the corporation for it, if it is not paid on demand. In some cases money or other property equal to the whole amount of the dividend declared has been specifically set apart as a fund appropriated to the payment of the dividend, and the stockholders have been regarded as the *cestuis que trust* of this fund, each entitled to his share. In other cases the corporation has credited the stockholders with the amount of their shares of the dividend, and the stockholders have assented to this, and the amount so credited has been regarded as a debt of the corporation to the stockholders; or the corporation has paid to some of the stockholders their shares of the dividend, and has refused to pay anything to the others, and it has been held that the corporation must pay all alike. See Beers *v.* Bridgeport Spring Co., 42 Conn. 17; State *v.* Baltimore & Ohio Railroad, 6 Gill, 363; King *v.* Paterson & Hudson River Railroad, 5 Dutch. 504; Jermain *v.* Lake Shore & Michigan Southern Railway, 91 N. Y. 483; Hopper *v.* Sage, 112 N. Y. 530; Jackson *v.* Newark Plankroad Co., 2 Vroom, 277; Wheeler *v.* Northwestern Sleigh Co., 39 Fed. Rep. 347. When a dividend has been declared payable at a definite future time, but no fund has been set apart for the payment of the dividend, and the corporation meanwhile becomes insolvent, whether the stockholders to the extent of their proportions of the dividend should share ratably with the creditors of the corporation in its property has not, so far as we know, been recently considered, but the decision in Lowene *v.* American Ins. Co., 6 Paige, 482, is that they should. The setting apart of a fund to pay a dividend has been held to give a lien upon it to the stockholders, which they can enforce to the exclusion of the general creditors of the corporation. In re LeBlanc, 14 Hun, 8, and 75 N. Y. 598; LeRoy *v.* Globe Ins. Co., 2 Edw. Ch. 657. The English Companies Act, 1862 (25 & 26 Vict. chap. 89, § 38, cl. 7), provides that 'no sum due to any member of a company, in his character of a member, by way of dividends, profits or otherwise shall be deemed to be a debt of the company, payable to such member in a case of competition between himself and any other creditor not being a member of the company; but any such sum may be taken into account, for the purposes of the final adjustment of the rights of the contributories amongst themselves.' Upon these questions, however, we desire to express no opinion. It has been argued that there is no consideration for the promise of a corporation to pay a dividend to its stockholders, but we think that the doctrine of consideration applicable to a simple contract between persons having no fiduciary relations to each other is not applicable to such promise. It is the object of a private business corporation to make money for its stockholders, and under our laws it is ordinarily the duty of the directors, from time to time, to declare dividends out of the net earnings, if there are any, and it must be left largely to the discretion of the directors to determine when and for how much such dividends should be declared. The whole property of the corporation is held on a sort of trust for the stockholders, and the directors are, in a general sense, the managers, and when a dividend is declared by the directors the declaration is a determination by a body authorized to make it that the amount of the dividend should be taken from the property of the corporation and paid over to the stockholders. The cause of action of each stockholder against the corporation for non-payment of the dividend does not arise from any actual contract between the corporation and its stockholders, but from the nature of the organization and the relation of the stockholders to the corporation and its property. Unless the rights of creditors intervene, or the corporation is enjoined from paying the dividend, on the ground that the dividend has not been earned, or on some other ground, the amount of the dividend, after it has been declared and has become payable, is considered as the property held by the corporation for the use of the stockholders individually, and the stockholders may recover their shares as money or property had and received to their use." Upon the point directly made here it was said: "We have been able to find little or no authority on the precise question involved in this case, namely, whether, after a dividend has been duly declared by a vote of the directors, but payable at a future time, the vote can be rescinded at a subsequent meeting of the directors, held before the time at which the dividend becomes payable according to the vote, when the fact that a dividend has been declared has not been made public or in any manner communicated to the stockholders, and when no fund has been set apart for the payment of the dividend. On principle, we do not see

§ 391. Contracts within and outside the power of private corporations.— It is not *ultra vires* a mining corporation to contract to advance a specified sum of money for the construction

of a tunnel to drain its mine, etc. Such a contract comes within the implied or incidental powers of such a corporation.[1] A contract between two corporations for consolidation, without express

why the directors may not rescind such a vote under the circumstances stated. By the vote no specific property passed to the stockholders. If the vote be regarded as a declaration of trust in favor of the stockholders it could be revoked before it was communicated to them or any property was identified or set aside for them. Indeed, cases may easily be supposed of such a change in the affairs of a corporation, between the time when a dividend is declared and the time when it becomes payable, to make the exercise of such a power by the directors useful, if not necessary, for the successful continuance of the business of the corporation. It appears in the present case that the meeting of the new directors at which the vote was rescinded was held after the annual meeting of the stockholders, but on the same day as the meeting of the directors at which the vote was passed, which was held just before the meeting of the stockholders, and that at the meeting of the stockholders 'the president did not, as had for many years been the custom, announce that any dividend had been declared or promulgate the same to the stockholders,' and it does not appear that any of the stockholders, except the directors, knew of the original vote, or that any of the stockholders had made any contracts, incurred any liability or done anything relying on the vote. It also appears that no fund was distinctly set apart for the payment of the dividend before the vote was rescinded. As the passage of the vote did not constitute an actual contract of the corporation with its stockholders, but was merely a mode of dividing the earnings of the property of the corporation among the stockholders, we are of opinion that before the division had been actually made, and before the position of the stockholders had been changed in reliance on the vote — certainly before the passage of the vote had been made public or communicated to the stockholders — it was within the power of the directors, at a meeting subsequent to that at which the vote was passed, to rescind it. In this action at law we cannot supervise the exercise of this power by the directors."

[1] Sutro Tunnel Co. *v.* Segregated Belcher Mining Co., (1885) 19 Nev. 121: s. c., 7 Pac. Rep. 271. HAWLEY, J., for the court, distinguished Davis *v.* Old Colony R. R. Co., 131 Mass. 258, and said: "It is apparent that the doctrines announced in that decision are not applicable to the facts of this case. There the benefits to the corporations were wholly disconnected, remote and foreign to the business in which they were engaged. Here the benefit to appellant is direct. The construction of the lateral tunnel, if not absolutely necessary, was certainly a convenient and appropriate means to drain its mine and enable it properly to conduct and carry on its legitimate business of mining in a systematic and scientific manner. In Brice's Treatise on the Doctrine of Ultra Vires it is said that 'Corporations may transact, in addition to their main undertaking, all such subordinate and connected matters as are, if not essential, at least very convenient to the due prosecution of the power,' and that, under many circumstances, 'they are in a manner necessitated to engage in business which is not within the mere letter of their constitution.' Green's Brice's

legislation authorizing it, would be *ultra vires*.[1] The Tennessee Supreme Court has held the guaranty of eight per cent dividend upon the stock of an elevator company, as an inducement to subscription to the capital stock of the latter, by a railroad corporation empowered by its charter "to do all lawful acts properly incident to a corporation and necessary and proper to the transaction of the business for which it was incorporated," with a declaration in its charter that it should "possess such additional power as may be convenient for the due and successful execution of the powers granted in their charter," was beyond its power.[2] In proceedings to condemn land for railroad purposes, where it appeared that one of the subscribers to the capital stock of the petitioning

Ultra Vires, 89. In applying these principles the courts have held that a corporation created for the purpose of mining and transportation of coal had the power to purchase and use a steamboat for the purpose of carrying its coal to market (Callaway M. & M. Co. *v.* Clark, 32 Mo. 305); that a corporation created for the purpose of raising and smelting lead ore had power to purchase smelting works and assume a a contract entered into by their vendors providing means for the transportation of their ores, when smelted, to market (Moss *v.* Averell, 10 N. Y. 455); that a corporation created for the purpose of carrying on an iron furnace is authorized to carry on a supply store in connection with that business (Searight *v.* Payne, 6 Lea., [Tenn.] 283); that railroad corporations have the right to own and control steamboats for the purpose of transporting their freight and passengers across navigable waters on the line of their routes, and also at the end of their roads, separating them from the substantial *termini* of their routes (Wheeler *v.* San Francisco & A. R. Co., 31 Cal. 65); that where power is given to a railroad corporation to transport persons and property beyond the *termini* of its road, it has authority to purchase and use a steamboat for that purpose (Shawmut Bank *v.* Plattsburg & M. R. Co., 31 Vt. 496); that a railroad corporation, authorized to carry passengers and transport freight beyond its own lines, and to run steamboats for that purpose, may hire, either by the trip or by the season, steamboats belonging to others, or employ such steamboats to carry passengers and freight in connection with its own railroad and business, and guarantee to the proprietors that their gross earnings for the season shall not fall below a certain sum. Green Bay & M. R. Co. *v.* Union Steamboat Co., 107 U. S. 101. These and numerous other kindred cases proceed upon the theory that if the contract of the corporation is reasonably confined and connected with the business in which the corporation is engaged it comes within its implied or incidental powers. 'Corporations may so far develop and extend their operations as to engage in matters not primarily contemplated by their founders, provided these matters come fairly within their scope, and provided, also, that in so developing and extending their undertaking they employ direct and not indirect means.' Green's Brice's Ultra Vires, 90."

[1] Home Friendly Society *v.* Tyler, (1890) 9 Pa. Co. Ct. Rep. 617.

[2] Memphis Grain & Elevator Co. *v.* Memphis & Charleston R. R. Co., (1887, Tenn.) 5 S. W. Rep. 52.

corporation was a corporation, and that its subscription was essential to make up the required amount, the New York Court of Appeals held that, in the absence ot any proof, it would not be presumed against the act of the corporation, and its payment of the percentage required that it acted beyond its powers.[1] Whether or not the purchase of real property in another state by a Vermont corporation was within its corporate powers, the Supreme Court of that state held it should account for the actual value of what it received.[2] Lending money by a trading corporation to one dealing with it to enable him to carry on the transactions is not *ultra vires* on the part of the corporation.[3]

§ 392. Rules as to estoppel to plead that contracts are ultra vires.— A corporation giving its note for the price of stock of another corporation cannot defend in a suit upon it on the ground that the corporation taking the note had no right to

[1] In the Matter of, etc., Rochester, Hornellsville & Lackawanna R. R. Co., (1888) 110 N. Y. 119; s. c., 17 N. E. Rep. 678.

[2] Moore *v.* Swanton Tanning Co., (1888) 60 Vt. 459; s. c., 15 Atl. Rep. 114. In Mallory *v.* Hanaur Oil Works, (1888) 2 Pickle, (Tenn.) 598; s. c., 8 S. W. Rep. 396, an agreement between two corporations engaged in manufacturing the same article, to select a committee composed of representatives of each corporation, and to turn over to this committee the properties and machinery of each corporation, to be managed and operated for the common benefit — the profits and losses to be shared in agreed proportions — was held to be but a contract of partnership, and that the contract was not within the express or implied powers of corporations organized under the Tennessee Incorporation Act of 1875 (Chap. 142), and was *ultra vires* and void so far as it was unexecuted, even though authorized by both shareholders and directors. This contract was entered into for three years; two years had expired. The court held it unexecuted as to the three years in the sense that it might be repudiated as *ultra vires*, and the property delivered at once recovered by the corporations, citing as authority Thomas *v.* Railroad Co., 101 U. S. 71. For a transaction on the part of a corporation which was held not to be within the prohibition of the Code of West Virginia forbidding one corporation to subscribe for or purchase stocks, bonds or securities of another, see County Court of Taylor County *v.* Baltimore & Ohio R. R. Co., (1888) 35 Fed. Rep. 161. When a corporation for brewing cannot become a surety, see Filon *v.* Miller Brewing Co., (1891) 60 Hun, 582; s. c., 15 N. Y. Supp. 57.

[3] Holmes, Booth & Haydens *v.* Willard, (1891) 53 Hun, 629; s. c., 5 N. Y. Supp. 610; affirmed in 125 N. Y. 75; s. c., 25 N. E. Rep. 1083. Illustrations of an *ultra vires* contract: Simmons *v.* Troy Iron Works, (1891) 92 Ala. 427; s. c., 9 So. Rep. 160; Shaw *v.* Campbell Turnpike Road Co., (1891, Ky.) 15 S. W. Rep. 245; Tennessee River Transportation Co. *v.* Kavanaugh (1891) 93 Ala. 324; s. c., 9 So. Rep. 395. Illustration of when a contract is executory and the defense of *ultra vires* may be made: Bowman Dairy Co. *v.* Mooney, 41 Mo. App. 665.

acquire title to the stock.[1] The receipt of goods purchased for a business outside of that authorized by the charter of a corporation will not estop the corporation from the defense that it was *ultra vires* in an action to recover the price.[2] In a case before the Court of Errors and Appeals of New Jersey it appeared that a

[1] Holmes & Griggs Manufacturing Co. *v.* Holmes & Wessell Metal Co., (1889) 53 Hun, 52; s. c., 5 N. Y. Supp. 937; affirmed in 127 N. Y. 252; s. c., 27 N. E. Rep. 831.

[2] Chewacla Lime Works *v.* Dismukes, (1889) 87 Ala. 344; s. c., 6 So. Rep. 122. As to estoppel of corporation by reception of benefits to complain of a contract as *ultra vires*, see Sherman Center Town Co. *v.* Morris, (1890) 43 Kans. 282; s. c., 23 Pac. Rep. 569; Sherman Center Town Co. *v.* Russell, (1891) 46 Kans. 382; s. c., 26 Pac. Rep. 715; Cunningham *v.* Massena Springs & Ft. C. R. Co., (1892) 63 Hun, 439; s. c., 18 N. Y. Supp. 600; Rio Grande Cattle Co. *v.* Burns, (1892) 82 Tex. 50; s. c., 17 S. W. Rep. 1043; McNab *v.* McNab & Harlin Manufg. Co., 62 Hun, 18; s. c., 16 N. Y. Supp. 448; Dewey *v.* Toledo, A. A. & N. M. Ry. Co., (1891) 91 Mich. 351; s. c., 51 N. W. Rep. 1063; Campbell *v.* Argenta Gold & Silver Mining Co., (1891) 51 Fed. Rep. 1; Bond *v.* Terrell Cotton & Woolen Manufg. Co., (1891) 82 Tex. 309; s. c., 18 S. W. Rep. 691. Estoppel to plead *ultra vires:* Manchester & L. Railroad *v.* Concord Railroad, (N. H. 1891) 20 Atl. Rep. 383; Witter *v.* Grand Rapids Flouring Mill Co., (1891) 78 Wis. 543; s. c., 47 N. W. Rep. 729; Sherman Center Town Co. *v.* Fletcher (1891) 46 Kans. 524; s. c., 26 Pac. Rep. 951; Heims Brewing Co. *v.* Flannery, (1891) 137 Ill. 309; s. c., 27 N. E. Rep. 286; First Nat. Bank *v.* Strang, (Ill. 1891) 27 N. E. Rep. 903; Columbia Electric Co. *v.* Dixon, (1891) 46 Minn. 463; s. c., 49 N. W. Rep. 244. When a secured creditor cannot object that a mortgage for a sum in excess of the indebtedness allowed by the charter of a corporation was *ultra vires* and invalid: Allis *v.* Jones, (1890) 45 Fed. Rep. 148. When a corporation cannot object that a purchase of a certain franchise by it was *ultra vires:* Starin *v.* Edson, (1889) 112 N. Y. 206; s. c., 19 N. E. Rep. 670. Objection that a contract was *ultra vires* open only to the state or a stockholder: Baker *v.* Northwestern Guaranty Loan Co., (1883) 36 Minn. 185; s. c., 30 N. W. Rep. 464. As to the rule that municipal corporations are not estopped to deny the validity of contracts *ultra vires* made by their officers, see Newbery *v.* Fox, (1887) 37 Minn. 141; s. c. 33 N. W. Rep. 333; Mayor *v.* Ray, 19 Wall. 468; Brady *v.* Mayor, etc., of New York, 20 N. Y. 312; Hague *v.* City of Philadelphia, 48 Pa. St. 527; Nash *v.* City of St. Paul, 8 Minn. 172. That contracts *ultra vires* on the part of a municipal corporation cannot be legalized by any action on its part in the way of acknowledgment, ratification or otherwise, see Lyddy *v.* Long Island City, (1887) 104 N. Y. 218; s. c., 10 N. E. Rep. 155. As to enjoining in behalf of stockholders, as *ultra vires*, the purchase of another railroad by a railroad corporation, see Mackintosh *v.* Flint & Pere Marquette R. R. Co., (1888) 34 Fed. Rep. 582. Estoppel of stockholders to complain that debt incurred was in excess of the limit of indebtedness fixed in charter: Poole *v.* West Point Butter & Cheese Assn., (1887) 30 Fed. Rep. 513. That one who has received the benefits of a contract is not in position to raise the question that the contract on the part of the corporation was *ultra vires*, see Dia-

railroad corporation had entered into a contract with another that the latter would build a line of railroad which was authorized by its charter; that the former would guarantee the bonds of the latter to cover the cost of construction of the road, and would take a lease for 999 years of the road from the latter, for which it would pay so much rental per annum; that the road was built, the bonds guaranteed, the lessee went into possession of the road under the lease, complied with its terms for nine years, and then sought to repudiate the contract as one which was *ultra vires* on its part. The court held that under the statement of facts it was an executed contract, and that the corporation must be held to the performance of its part of the contract, the other having performed its side of the same, and the plea of *ultra vires* was not available for avoiding a specific performance.[1]

mond Match Co. *v.* Roeber, (1887) 106 N. Y. 473; s. c., 13 N. E. Rep. 419. When one contracting with a corporation cannot set up as a defense to a suit upon such contract that it was *ultra vires* on the part of the corporation, see Slater Woolen Co. *v.* Lamb, (1887) 143 Mass. 420; s. c., 9 N. E. Rep. 823. Estoppel of one receiving benefits to plead lack of power on the part of the corporation: Watts-Campbell Co. *v.* Yuengling, (1889) 51 Hun, 302; s. c., 3 N. Y. Supp. 869.

[1] Camden & Atlantic R. R. Co. *v.* May's Landing & Egg Harbor City R. R. Co., (1886) 48 N. J. Law, 530; s. c., 7 Atl. Rep. 523. VAN SYCKEL, J., speaking for the court, after referring to the numerous cases, English and American, touching this question, said: "In the conflict of judicial decision on this subject, this court may adopt and should adopt the rule which will produce the best results in the administration of justice. In my judgment the true rule is that when the transaction is complete, and the party seeking relief has performed on his part, the plea of *ultra vires* by the corporation which has acquiesced in it, is inadmissible in an action brought against it for not performing its side of the contract in all those instances where the party who has performed cannot, upon rescission, be restored to his former status. In the cases maintaining the contrary doctrine the reasoning of the courts has been: 1. That corporators might, by ratifying corporate acts, by their acquiesence, infinitely extend and amplify their granted powers. 2. That consent on the part of those who do an act which they have no power to do cannot make it legal. 3. That to hold that an act performed in executing a void contract makes all its parts valid, is to say that the more that is done under an unauthorized contract, the stronger is the claim to its enforcement by the courts. To the first objection a sufficient answer is that the state may interpose its authority at any time, and compel an abandonment of the act in excess of power, and, if need be, revoke the charter of the company for its usurpation. When the state challenges the legality of the transaction, the paramount and only question is whether it has bestowed upon the company the requisite authority to engage in it. When the question arises between the company and the other party to the contract, other legal principles apply in determining whether the contract shall be observed. It will be admitted that where there is an absence of authority on the part of a corporation to do an act the requisite power cannot be imported into the transaction, either by the consent of stockholders or by the execution of the contract by the other party to the agreement. The contract must necessarily continue to be *ultra vires*. No such effect has been attributed in any of the cases to acquiescence or unilateral performance. The basis upon which the enforcement of the contract in such cases rests is that the company is estopped from setting up its own unauthorized act, and its own incapacity to evade performance on its part, after receiving the fruits of the bargain. The power of the company is not amplified, the agreement is none the more legal, in the sense that there was authority to execute it; the court simply refuses to entertain the defense which common honesty forbids the company to make. A man may become bound by the act of an unauthorized agent, and be held liable to the contract made for him, not on the ground that the agent in fact had any authority, but for some conduct on the part of the alleged principal which precludes him from raising the question of authority. No reason is perceived why the rules of fair dealing, which are so rigorously applied to natural persons, shall not pertain as strictly to private corporations. No instance is known where a natural person can set up in his own behalf, and for his own advantage, his want of authority to do an act for which he has received the consideration from the other party. Transactions which are immoral, illegal, forbidden by statute or contrary to public policy, are not embraced in this discussion; they cannot furnish the basis for a legal cause of action. Why is it that *ultra vires* contracts are recognized as unassailable, and are permitted to stand as the foundation of rights acquired under them after they have been executed on both sides? Such execution imparts no additional powers to the corporate body. It does not transmute the negative into the positive. The absence of power is as apparent after as before performance. Why is it that corporations are compelled to pay money borrowed in excess of authority, and to pay the stipulated rent for premises unlawfully leased for the period of occupation? The law does not imply a contract to pay the bondholders the money they received. It is illogical to say that the law will imply a contract by the company which it has no power to make for itself. A contract cannot be implied where an express contract cannot be made. The law recognizes the obligation; it precludes or estops the attempt to evade it. Apply to it what legal phrase you may, the underlying principle is that the corporation cannot set up its own infirmity when it is unconscionable to do so. The law forbids the defense on account of the flagrant injustice which would otherwise be done. The question of corporate power is not entertained. To enable recompense to be had to this extent the contracts are respected, not that they rest in authority, but because good conscience requires it. * * * But acquiescence in it, upon which the other party acts, may, and does, upon settled legal principles, preclude the parties from starting the question of power as between themselves. There is, in fact, a subsisting contract, actually executed in due and legal form, which, under the rule stated, is unimpeachable, except at the instance of the state. It is thus, in legal contemplation, impressed with the vigor and incidents of a valid contract as between the parties, and there is no difficulty in enforcing it in a suit of law."

As to "Fiscal Management — Private Corporations," see further, chapter 4, "Power of Agents and Officers — Private Corporations."

CHAPTER XVIII.

COUNTY BONDS.

§ 393. County bonds generally.
394. Bonds issued for refunding indebtedness.
395. Bonds not within the power of a Texas county to issue for the erection of court houses.
396. Rights of holders of such bonds.
397. The effect of a statute of Texas as to county bonds in which school funds may be invested.
398. Validity of bonds as affected by the place of execution.
399. Validity of bonds as affected by constitutional requirements.
400. Validity of bonds as affected by limitations as to indebtedness.
401. The validity of judgments against a county for which the bonds were issued cannot be questioned in actions on the bonds.
§ 402. The statements of a county's agent in sale of the bonds not operative as an estoppel upon the county to refund.
403. When a county may plead an overissue.
404. When the defense that a county was not fully organized when the bonds were issued is not open to the courts.
405. Counties suable in federal courts.
406. Plea of Statute of Limitations on county bonds.
407. When statute as to presentation of claims is not applicable to judgments upon bonds and coupons.
408. The proper proceeding of courts where some of the bonds of a series are valid and others invalid.

§ 393. County bonds generally.— The power of counties to issue bonds is not inherent or general.[1] When municipal bonds are found in circulation, it will be presumed that the legal steps have been taken to authorize their issue.[2] Bonds issued by county commissioners for the purpose of constructing public buildings must bear interest payable annually. If bonds were issued for interest, payable in a shorter period, the Indiana Supreme Court held their issuance might be enjoined. The statute authorizing them should be strictly complied with.[3] Municipal bonds are a class of negotiable paper.[4] The Illinois Supreme Court has held as to these bonds that their negotiable character would not protect the purchaser, before maturity, against the consequences

[1] Thayer *v.* Montgomery County, 3 Dill. 389. As to the power to issue bonds, see Supervisors of Schuyler County *v.* Farwell, 25 Ill. 181.

[2] Maxcy *v.* Williamson County, 72 Ill. 207.

[3] English *v.* Smock, 34 Ind. 115.

[4] Callanan *v.* Brown, 31 Iowa, 333; Griffith *v.* Burden, 35 Iowa, 138.

of a want of authority to issue them; also, that the bonds having been issued without authority and, therefore, void, the mere levy of taxes and payment of interest on them by the county did not render them valid.[1] A county will not be deprived, by its bonds having passed by assignment into the hands of *bona fide* holders, of any defense which it would have against parties to whom the bonds were issued.[2] A municipal corporation will not be bound

[1] Supervisors of Marshall County *v.* Cook, (1865) 38 Ill. 44. The court distinguished certain cases relied upon as contrary to its views in these words: "In the case of Mercer County *v.* Hackett, 1 Wall. 83, it was held that slight and immaterial omissions in ordering the bonds to issue will not render them invalid in the hands of an innocent holder. In that case the recommendation was by the grand jury, the body authorized by law to make it, but they did not make it in the precise language of the law, but it was substantially good. If the recommendations had been made by the petit jury it would have presented a very different question and one more like the one under consideration than the one discussed in that case. We do not see that the court could have done otherwise than decide as they did. It was not a question of power to act, but whether the action, defective though it might be, was still in pursuance of the power. It is supposed that the case of Gelpcke *v.* City of Dubuque, 1 Wall. 175, is in conflict with the views here expressed. It will be observed, however, that so far as the record discloses in that case, the law authorizing the bonds to issue had been strictly observed in every particular before they were issued. A curative act had been passed by the legislature declaring the bonds valid and binding. That case does not, like the present, depend upon the power of the body issuing them to act, but upon other and different questions, the principal one of which was the constitutionality of the law. Hence, that case and this differ essentially in the questions presented and discussed. It is true the court use broad and comprehensive language. They say: 'When a corporation has the power, under any circumstances, to issue negotiable securities, the *bona fide* holder has a right to presume they were issued under the circumstances which gave the requisite authority, and they are no more liable to be impeached for any infirmity in the hands of such holder than any other commercial paper. If there were any irregularity in taking the votes of the electors, or otherwise, in issuing the bonds, it is remedied by the curative provisions of the act of January 28, 1857.' The court, however, do not intimate that such instruments, issued without power, would be protected in the hands of any kind of a holder. The court proceed upon the ground that the persons issuing the bonds did so in the exercise of a power. And that if there was a defective exercise of the power, the irregularity had been cured by the act of the legislature. There is no intimation that bonds void in their inception — issued in direct violation of law — would be protected. Nor do we believe that court will so hold if this question should ever be presented for their determination."

[2] Board of Commissioners of Madison County *v.* Brown, 28 Ind. 161. In Melvin *v.* Lisenby, 72 Ill. 63, the county was authorized to issue bonds by a law providing that the bonds should be executed by certain officers, and countersigned by the county treasurer of the

by an issue of bonds in excess of the constitutional limit of municipal indebtedness; neither will it be liable to pay back what has been received thereon.[1] In case bonds purport to have been issued by virtue of a certain order, named and referred to, but not copied or described, those claiming any rights by virtue of such bonds are chargeable with notice of the contents of the order.[2] Where there are recitals in county bonds that they were issued in accordance with the statute and authorized by a vote of the people made by officers invested by the statute with the power of deciding whether these conditions have been fulfilled or not, the bonds will not be open to the defense of want of consideration or of fraud on the part of the officers, or of non-compliance with the conditions precedent to the right to exercise the power.[3] To provide a site for a state institution was held by the Illinois Supreme Court not to be a corporate purpose, and bonds issued by a county for such a purpose were held to be void; and that no matter in whose hands such bonds might be, where a tax had been levied and collected for their payment, or for the payment of the accrued interest upon them, the county treasurer might be restrained from applying the money collected for the payment of the bonds or interest.[4] Bonds issued by a county in payment of a judgment, under authority of statute, have been held in Iowa to be valid in the hands of a purchaser in good faith, for value, without notice of any claim that they were illegal for any cause, although the indebtedness for which the judgment was rendered was in excess of the constitutional limit of indebtedness, such defense not having been interposed in the suit by the board of supervisors of the county.[5] It is now well settled that where bonds of a county or municipality have been issued under authority of law, and where, at the same time, the law has directed

county. The court held the omission of the county treasurer to countersign the bonds to be a mere defect in the execution of them which a court of equity would, in the absence of a remedy at law, ordinarily supply, and that an injunction restraining the collection of taxes for the payment of the bonds issued should not be allowed.

[1] McPherson *v.* Foster, 43 Iowa, 48.

[2] Lewis *v.* Bourbon County, 12 Kans. 186.

[3] Carpenter *v.* Buena Vista County, 5 Dill. 556. The principle that the recital upon the face of bonds made a part of the bonds, must show that they were issued for some authorized purpose or object, applied in Thayer *v.* Montgomery County, 3 Dill. 389.

[4] Board of Supervisors of Livingston County *v.* Weider, (1872) 64 Ill. 427.

[5] Sioux City & St. Paul R. R. Co. *v.* Osceola County, 45 Iowa, 168; s. c., again in 52 Iowa, 26.

a tax to be levied for their protection, or where there is a general law authorizing and directing a tax in all like cases, applicable to said bonds, the law becomes a part of the contract. The holder is entitled to look to the taxing provisions as a part of his security, and has a vested right to demand, at the proper time, that it shall be exercised in his favor. The measure of that right will be the constitutional limit of the power which the legislature could grant to the municipality when the contract was made. Such contracts are protected by the Constitution of the United States, and no subsequent act of a state legislature or a constitutional convention can impair them.[1]

§ 394. Bonds issued for refunding indebtedness.— It appeared in a case before the United States Circuit Court of Appeals, an action upon refunding bonds of a county in Michigan, that suits had been brought upon the bonds originally issued, the holders had judgments against the county for the amounts due; that an act of the legislature was passed authorizing the county authorities to refund the county's indebtedness; that the county authorities did so, issuing the bonds which were the base of this action and giving them in exchange for the original bonds and judgments which constituted the indebtedness, the refunding of which the act authorized. The court held that, under the circumstances of this case, the bonds issued to refund the supposed indebtedness of the county were binding obligations upon the county.[2]

[1] Brodie *v.* McCabe, Collector, (1878) 33 Ark. 690.

[2] Ashley *v.* Board of Supervisors of Presque Isle County, (1893) 60 Fed. Rep. 55. The court said: "The former bonds were more than colorable obligations. Recoveries had been had in the United States Circuit Court against the reorganized county upon some of them, and the validity of the remaining ones was, to say the least, a fair question for controversy. The county chose not to make further defense to the bonds, and to avail itself of the opportunity to defer the payment of the indebtedness and to obtain a reduction of the interest from ten to seven per cent. It sought and obtained from the legislature authority to refund its debt. It procured the surrender of the former bonds and issued in their stead and in consideration of them, the new bonds. If the legislature did not assume the former bonds to be valid, it devolved upon the board of supervisors of the county to determine what were valid obligations of the county in exercising the authority to issue the new bonds conferred by the act, and such determination would bind the county. In the case of The City of Cadillac *v.* Woonsocket Institution, 58 Fed. Rep. 935, bonds had been issued under the guise of a law authorizing

§ 395. Bonds not within the power of a Texas county to issue for the erection of court houses.— Bonds issued by a county in Texas for the construction of a building intended primarily for a jail, to which use it was to be permanently devoted, though it was the purpose of the county commissioners to use it also as a court house until a court house could be built, the Supreme Court of that state held were not authorized by the laws of that state providing for the erection of court houses.[1]

public improvements for the actual purpose of aiding a railroad company. The bonds were in the hands of one who knew of the fraudulent evasion of the Constitution of the state, and no action could have been maintained upon them by him. But they were negotiable, and might have been put upon the market by him. In this state of affairs, the common council of the city, upon the request of a large number of its citizens, and upon considerations deemed by the council to justify it, issued new bonds to take up the former ones, under the provisions of the Michigan statute for refunding municipal indebtedness. The new bonds were exchanged for the old, and passed into the hands of *bona fide* holders, who brought suit upon them. One question involved in the case was, whether a buyer of the bonds — which on their face were refunding bonds — was bound to go back of the issue of the new bonds, which were regular on their face and contained recitals that they were issued in conformity with law, and ascertain the nature of the refunded indebtedness. The refunding statute did not, in terms, declare who should determine the fact of previous indebtedness. But, Judge LURTON, in delivering the opinion of the court, said: 'Power was conferred upon the common council to issue new bonds to take up old ones falling due. The question as to whether there were any such bonds is referred to the council. The old bonds, as the facts found, were at least colorable obligations. The council determined to issue new bonds to take them up. It seems to me that, under the circumstances, it did not devolve upon the purchaser of the new bonds to look into the validity of the funded old bonds.' Citing Coloma *v.* Eaves, 92 U. S. 484; Hackett *v.* Ottawa, 99 U. S. 86, and Chaffee Co. *v.* Potter, 142 U. S. 355; s. c., 12 Sup. Ct. Rep. 216. In the present case, the force of these suggestions is augmented by the fact that, by express provision of the Constitution of Michigan, boards of supervisors are empowered to adjust all claims against their respective counties, and from their decision there is no appeal. This jurisdiction is not exclusive, but, as against the county, any one having demands against it could obtain from the board a conclusive determination upon them. To require the purchaser of refunding bonds to scrutinize the sucessive issues in which the debt has been refunded to its root, would seriously impair the market value of the bonds, or otherwise work injuriously to the interests of the municipality issuing them."

[1] Nolan County *v.* The State, (1891) 83 Tex. 182. As to the power of counties in such cases, it was said: "It may be considered settled law in this state that one of its counties cannot issue bonds without an act of the legislature conferring that power. Robertson *v.* Breedlove, 61 Tex. 316. The case cited is also authority for holding that the act by virtue of which the bonds in question were issued, conferred

§ 396. Rights of holders of such bonds.— The Texas Supreme Court considered the question of the rights of the holder of certain county bonds issued by a county under the statute of that state authorizing the issuance of bonds for the erection of court houses, which bonds the court held were issued without authority, with the result of this declaration of the law controlling in this case: "[These] bonds are payable to bearer and in all other respects they are regular upon their face. They recite that they were issued for the purpose of erecting a court house for [defendant] county, and in pursuance of the authority conferred by the act of February 11, 1881. They also purport to have been registered by the treasurer of the county. The state is admitted to be a holder for value of the four bonds of this series which are in part the foundation of this suit; and it is also admitted that at the time of their purchase its agents had no actual notice of any fact which impaired their validity. The county [defendant] had no court house, and, therefore, the Commissioners' Court had power to issue bonds for the erection of such a structure containing all the recitals necessary to show the authority for the creation of the debt. If a purchaser were bound to inquire into the existence of the facts which empowered the court to issue bonds to build a court house, and to know that the county had no court house, in view of the recitals upon the face of the obligations he was bound to look no further. He had the right to rely upon the truth of such recitals, and having paid value for the bonds without actual knowledge of their ille-

authority to issue bonds upon such counties only as had no court house at their county seat. We think it equally clear that the only purpose for which the power could be exercised was to provide the means for building a court house. The act of February 2, 1884, which authorizes the issue of bonds for the construction not only of court houses but also of jails, tends to show that such is the legislative construction of the act under consideration. * * * Therefore, at the threshold of the discussion we are met with the question whether there was any authority whatever for the issue of the first series of bonds. It is not to be supposed that the legislature intended to confer the power upon the counties to create a bonded indebtedness to build a temporary structure to be used as a court house until a permanent building could be constructed. The limitations in the Constitution upon the creation of municipal debts, and the great caution manifested in conferring power upon municipal corporations to issue bonds, repel the idea that it could have been the purpose to authorize counties to issue them for the purpose of building other than permanent court houses."

gality, the county would be estopped to set up that they were not issued for the purpose for which they purported to be issued."[1]

§ 397. The effect of a statute of Texas as to county bonds in which school funds may be invested.— The state of Texas, having invested certain school funds in some of the bonds issued by the county in this case, was held to be protected by the statutes of Texas, which provided that: "In all cases where the proceeds of the sale of any bonds have been received by the proper officers of the county, or by a party acting for it in negotiating the sale thereof, such county shall be thereafter estopped from denying the validity of such bonds so issued, and the same shall be held to be valid and binding obligations of the county, and in any action upon such bonds or coupons thereto, judgment shall be rendered against the county for the amount of the bonds sued on and interest thereon at the rate mentioned therein, deducting such amounts, if any, as have been previously paid thereon." "The payment of any interest upon any bond heretofore purchased, or that may hereafter be purchased, with public school funds, or belonging thereto, shall be deemed and held a waiver of any supposed error, irregularity, or want of authority affecting or tending to affect the validity of any such bonds; and the same shall thereafter be held valid and binding obligations upon the county by which they appear or purport to have been issued, notwithstanding such supposed error, irregularity or want of authority as aforesaid." The court held the statutes to be constitutional, and also held adversely to the contention on behalf of the county that the statutes applied only to such bonds as may have been purchased by the state directly from the counties.[2]

[1] Nolan County *v.* The State, (1891) 83 Tex. 182, 194, 195, holding the bonds valid in the hands of the holder, unless the entire issue of the bonds was in excess of the amount of the indebtedness which the county was authorized by law to create. The Texas court recognized as authority for their ruling the following cases, to wit: Chambers County *v.* Clews, 21 Wall. 321; Wilson *v.* Salamanca, 99 U. S. 504; Marcy *v.* Oswego, 92 U. S. 640; Humboldt *v.* Long, 92 U. S. 644; Daviess County *v.* Huidekoper, 98 U. S. 100.

[2] Nolan County *v.* The State, (1891) 83 Tex. 182. It was said by the court: "That the provisions in question are not repugnant to the Constitution in the particulars urged against them, we think too well settled to require discussion. Ritchie *v.* Franklin County, 22 Wall. 74; New Orleans *v.* Clark, 95 U. S. 644; Cooley Const. Lim. (4th ed.) 466, 467. It can hardly be deemed an open question in this court. Morris *v.* The State, 62 Tex. 741; Blum *v.* Looney, 69 Tex. 3. Where a contract which a municipal corporation has attempted to create is invalid merely for want of legislative authority to create it, it can be made valid by a subsequent law. But if at the time of its attempted creation the legislature could not have authorized it, it may be doubted whether the legislature could make it valid, although in the meantime, by a change in the Constitution, the restriction upon its own power may have been removed. * * * There is nothing in the language of the validating act which indicates that it was not to be applied to bonds which may have been bought by the state after they had been transferred by the county to third parties. The object of the provision was to protect the school fund, and we see no reason why it was not intended to validate any county bond held by the state for the benefit of its public schools, whether purchased directly from the county or from intermediate holders." For a case holding bonds issued by a county for the erection of a court house and jail to be valid by force of an act of the legislature having the effect to make them valid by a subsequent grant of power to the county, and how far a *bona fide* purchaser without notice of any defect is protected, see Ball *v.* Presidio County, (Tex. Civ. App. 1894) 27 S. W. Rep. 702.

§ 398. Validity of bonds as affected by the place of execution.— A contractor for the erection of a court house in a county of Iowa having completed his contract, the county judge of the county delivered to him county bonds in payment. It would seem that these bonds proved not so negotiable as the contractor desired, and afterwards the county judge went to New York with the contractor and there made and issued to him new bonds for the same amount, differing in the amount of each, in time of payment, and in amount of coupons, and in other particulars; and he had a seal made there which he called the seal of the county, and affixed the seal to them and then delivered them to the contractor. The bonds were payable to the contractor or bearer. They were afterward sold to a third person, and upon his death his son brought action against the county upon them. The Code of Iowa at the time authorized the county judge, sitting as a County Court, to provide for the erection and reparation of court houses, jails and other necessary buildings within and for the use of the county. The question as to construction of the court house, levy of the special tax for the purpose, etc., was properly submitted to the voters of the county as required by the Code; a majority of the voters favored the proposition. The United States Supreme Court held that the issue of the bonds was authorized; that the county judge was clothed with the duty of deciding upon the question, and his decision, in the absence of fraud or collusion, was final, and neither party could go behind

it.[1] They further held that it was no valid objection that the bonds were made payable and were sold beyond the limits of the county and of the state; that the power to issue them carried with it authority to the county judge as to both these things — to do what he deemed best for the interests of the county for which he was acting.[2]

§ 399. Validity of bonds as affected by constitutional requirements.— County records, when pointed to by the laws or constitutional provisions relating to the issuance of county bonds as evidence of facts required to authorize their issuance, and not the recitals in the bonds, must be looked to by all persons purposing to deal in the bonds. So, in this case, county bonds were held invalid, even in the hands of *bona fide* purchasers, they having been issued without compliance with the constitutional requirements that provision should be made at the time of incurring any debt for levying a sufficient tax to create a sinking fund of two per cent, in addition to meeting the interest.[3]

[1] Lynde *v.* The County, (1872) 16 Wall. 6. Mr. Justice SWAYNE, speaking for the court, referred to the rulings in Iowa on this subject in these words: "In Iowa every county is a body corporate. In Clapp *v.* The County of Cedar, 5 Iowa, 15, it was said by the Supreme Court of the state that the office of county judge being created and his powers and duties defined by statute, the principles of the law of agency where those powers and duties are drawn in question, have no application; that 'he is the living representative and embodiment of the county,' and that 'his acts are the acts of the corporation.' In Hull & Argalls *v.* The County of Marshall, 12 Iowa, 142, it was held that by virtue of his general authority he might contract for the building of a court house to be paid for out of the revenue of the county, but that when a debt was to be incurred for that purpose special authority must be conferred by a popular vote in the manner provided by the statute. It was further held that where a loan was thus authorized, the form of the securities not being prescribed, negotiable bonds might be issued. The statute provides that the judge may submit to the people, at a regular or special election, 'the question whether money may be borrowed to aid in the erection of public buildings,' and other questions not necessary to be mentioned; and that 'when the question so submitted involves the borrowing or expenditure of money,' it 'must be accompanied by a provision to levy a tax for the payment thereof,' and that 'no vote adopting the question proposed will be of effect unless it adopt the tax also.'"

[2] Lynde *v.* The County, (1872) 16 Wall. 6.

[3] Quaker City National Bank *v.* Nolan County, (1894) 59 Fed. Rep. 660; citing Citizens' Bank *v.* City of Terrell, 78 Tex. 456; s. c., 14 S. W. Rep. 1003; Dixon County *v.* Field, 111 U. S. 84; s. c., 4 Sup. Ct. Rep. 315; Lake Co. *v.* Graham, 130 U. S. 682 s. c., 9 Sup. Ct. Rep. 654; Nolan Co. *v.* State, 83 Tex. 183; s. c., 17 S. W. Rep. 823; Francis *v.* Howard Co., 54 Fed. Rep. 487; s. c., 50 Fed. Rep. 60; 4 C. C. A. 460. It was held further that the legislature of Texas had no power to validate county bonds issued in violation of constitutional provisions which were alive and in force at the date of the validating act. Further, that a decision of the Supreme Court of that state, sustaining the statute which validated certain county bonds, was not controlling on the federal court, where it appeared that the bonds were void for failure to comply with a provision of the State Constitution, but that this point was not called to the attention of the state court, and its decision was based on other grounds.

§ 400. Validity of bonds as affected by limitations as to indebtedness.— The effect of the constitutional provision of Texas, which it had been held limited the amount of indebtedness which counties, towns and cities were authorized to create for the erection of public buildings, etc., to twenty-five cents upon $100 worth of property as shown by the assessment rolls of the municipality,[1] was considered by the Supreme Court in connection with the other questions involved with reference to the county bonds for the erection of a court house issued in a case before that court.[2] The court had also held in a previous case that the word "valuation," as used in the constitutional provision, meant the value as fixed by competent authority for the purposes of taxation.[3] The result of the decisions in the case last cited, the court in this case stated to be that the governing boards of municipal corporations in that state are not empowered, when ascertaining the amount of an indebtedness to be created, to determine for themselves the aggregate value of the property therein subject to taxation, but are to be governed by the official rolls made out by the tax assessor. The power being limited as to the amount of the official assessment, it was held that the commissioners were not authorized to look beyond it and to determine the extent of their power from other data within their reach.[4] The court held that as to the excess of these bonds, over

[1] See Citizens' Bank *v.* Terrell, 78 Tex. 450.

[2] Nolan County *v.* The State of Texas, (1891) 83 Tex. 182.

[3] Citizens' Bank *v.* Terrell, 78 Tex. 450.

[4] Nolan County *v.* The State of Texas, (1891) 83 Tex. 182. The rule established in Dixon County *v.* Field, 111 U. S. 94, and acted upon in Citizens' Bank *v.* Terrell, 78 Tex. 450, was held applicable in such a case. The court said: "If our Constitution were silent upon the subject, then it might reasonably be held that [the following section of the statutes with reference to building court houses, to wit: 'The county shall not issue a larger amount of bonds than a tax of one-fourth of one per cent annually will liquidate in ten years, and said bonds shall only be

the sum authorized under this construction of the constitutional and statutory provisions, the bonds were void; but, having been issued at the same time, each would bear a relative proportion of the loss; and that, as to the excessive issue of these bonds, the purchasers of the bonds could not claim to be innocent purchasers.[1] In an action upon county bonds issued for the construction of bridges, reciting on their face facts as to their issue in conformity to the laws of Colorado upon the subject, one defense was that the bonds were illegal and void, because they increased the indebtedness of the county to an amount in excess of the limit prescribed by the Constitution of the state. The case came before the Supreme Court of the United States upon a certificate which stated that at the time of the issue of the bonds in question the defendant county was in fact indebted beyond the constitutional and statutory limit, and the issue of each bond, therefore, created a debt in excess of that limit; and that the plaintiff bought the bonds upon the faith of the recitals therein, and without making any examination into the facts appearing upon the records of the county. The statute of the state of Colorado required the county commissioners, in submitting the question to a vote of the electors, to enter of record an order specifying the amounts required and the object of the debt; and also made it

sold at their face par or value,'] authorized the Commissioners' Courts to determine the question as to the amount of bonds 'a tax of one-fourth of one per cent annually will liquidate in ten years.' But there being a provision in the Constitution bearing directly upon that subject, we are of the opinion that this section must be construed in connection with it. The limit in the Constitution being an amount upon which a tax of one-half of one per cent would pay annually the interest and two per cent as a sinking fund, and the statutory requirements being such an amount only as one-fourth of one per cent would liquidate in a period of ten years, it was not absolutely necessary that the commissioners should be governed by the same rule in determining the two limits. An amount of indebtedness that would be liquidated within ten years, though based upon a valuation in excess of that shown by the assessment rolls, might still be within the constitutional limit which permits the creation of such a debt as will be ultimately paid by an annual tax of one-half of one per cent upon the taxable values of the county as shown by the official assessment. But we think it more reasonable to presume that the legislature intended that the same rule should govern in determining both limits, and that the Commissioners' Courts should not look beyond the assessment rolls in ascertaining the amount of the indebtedness which the statute authorizes them to create."

[1] Nolan County *v.* The State of Texas, (1891) 83 Tex. 182, following Russell *v.* Cage, 66 Tex. 428; Citizens' Bank *v.* Terrell, 78 Tex. 450.

their duty to publish, and to cause to be entered on their records, open to the inspection of the public at all times, semi-annual statements exhibiting in detail the debts, expenditures and receipts of the county for the preceding six months, and striking the balance so as to show the amount of any deficit and the balance in the treasury. The court held that the holder of these bonds, although a purchaser for value and before the maturity of the bonds, was charged with the duty of examining the record of indebtedness provided for by the statute of Colorado in order to ascertain whether the bonds increased the indebtedness of the county beyond the constitutional limit; and that the recitals did not estop the county to prove by the records of the assessment and the indebtedness that the bonds were issued in violation of the Constitution of the state.[1] The county treasurer of a county

[1] Sutliff *v.* Lake County Comrs., (1893) 147 U. S. 230. Mr. Justice GRAY, speaking for the court, said: "In those cases in which this court has held a municipal corporation to be estopped by recitals in its bonds to assert that they were issued in excess of the limit imposed by the Constitution or statutes of the state, the statutes, as construed by the court, left it to the officers issuing the bonds to determine whether the facts existed which constituted the statutory or constitutional condition precedent, and did not require those facts to be made a matter of public record. Marcy *v.* Oswego, 92 U. S. 637; Humboldt *v.* Long, 92 U. S. 642; Dixon County *v.* Field, 111 U. S. 83; Lake County *v.* Graham, 130 U. S. 674, 682; Chaffee County *v.* Potter, 142 U. S. 355, 363. But if the statute expressly requires those facts to be made a matter of public record, open to the inspection of every one, there can be no implication that it was intended to leave that matter to be determined and concluded, contrary to the facts so recorded, by the officers charged with the duty of issuing the bonds. Accordingly, in Dixon County *v.* Field, 111 U. S. 83, which arose under an article of the Constitution of Nebraska, limiting the power of a county to issue bonds to ten per cent of the assessed valuation of the county, it was adjudged that a county issuing bonds, each reciting that it was one of a series of $87,000 issued under and by virtue of this article of the Constitution and the statutes of Nebraska upon the subject, was not estopped to show by the assessed valuation on the books of public record of the county that the bonds were in excess of the constitutional limit; and Mr. Justice MATTHEWS, delivering the unanimous judgment of the court, fully stated the grounds of the decision, which sufficiently appear by the following extract: 'If the fact necessary to the existence of the authority was by law to be ascertained, not officially by the officers charged with the execution of the power, but by reference to some express and definite record of a public character, then the true meaning of the law would be that the authority to act at all depended upon the actual objective existence of the requisite fact, as shown by the record, and not upon its ascertainment and determination by any one; and the consequence would necessarily follow, that all persons

of the state of New York, under the authority of a resolution of its board of supervisors, and certain statutes then in force, offered for sale and invited bids for bonds of the county aggregating a certain large amount. The bidder in one instance, whose bid was accepted, first gave a check for the sum bid for a certain amount of the bonds, and then stopped payment on the same, and declined to receive them, claiming that the issue of such bonds

claiming under the exercise of such a power might be put to the proof of the fact, made a condition of its lawfulness, notwithstanding any recitals in the instrument.' Dixon County *v.* Field, 111 U. S. 83, 93. In the present case there was no power at all conferred to issue bonds in excess of an amount equal to ten per cent upon the assessed valuation of the taxable property in the county. In determining the limit of power, there were necessarily two factors: The amount of the bonds to be issued, and the amount of the assessed value of the property for purposes of taxation. The amount of the bonds issued was known. It is stated in the recital itself. It was eighty-seven thousand dollars. The holder of each bond was apprised of that fact. The amount of the assessed value of the taxable property in the county is not stated; but, *ex vi termini*, it was ascertainable in one way only, and that was by reference to the assessment itself, a public record equally accessible to all intending purchasers of bonds, as well as to the county officers. This being known, the ratio between the two amounts was fixed by an arithmetical calculation. No recital involving the amount of the assessed taxable valuation of the property to be taxed for the payment of the bonds can take the place of the assessment itself, for it is the amount, as fixed by reference to that record, that is made by the Constitution the standard for measuring the limit of the municipal power. Nothing in the way of inquiry, ascertainment or determination as to that fact is submitted to the county officers. They are bound, it is true, to learn from the assessment what the limit upon their authority is, as a necessary preliminary in the exercise of their functions, and the performance of their duty; but the information is for themselves alone. All the world besides must have it from the same source, and for themselves. The fact, as it is recorded in the assessment itself, is extrinsic and proves itself by inspection, and concludes all determinations that contradict it. Dixon County *v.* Field, 111 U. S. 83, 95." Mr. Justice GRAY then resumed: "That decision and the grounds upon which it rests were approved and affirmed in Lake County *v.* Graham, 130 U. S. 674, and Chaffee County *v.* Potter, 142 U. S. 355, * * * each of which arose under the article of the Constitution of Colorado now in question, but under a different statute, which did not require the amount of the indebtedness of the county to be stated on its record. In Lake County *v.* Graham each bond showed on its face the whole amount of bonds issued, and the recorded valuation of property showed that amount to be in excess of the constitutional limit; and for this reason, as well as because the bonds contained no recital upon that point, the county was held not to be estopped to plead that limit. Lake County *v.* Graham, 130 U. S. 674, 682, 683. In Chaffee County *v.* Potter, on the other hand, the bonds contained an express recital that the total amount of the issue did not exceed the constitutional limit, and did not show on their face the amount of the issue, and the county records showed only the valuation of the property, so that, as observed by Mr. Justice LAMAR, in delivering judgment: 'The purchaser might even know, indeed, it may be admitted that he would be required to know, the assessed valuation of the taxable property of the county, and yet he could not ascertain by reference to one of the bonds and the assessment roll whether the county had exceeded its power, under the Constitution, in the premises.' Chaffee County *v.* Potter, 142 U. S. 355, 363. The case at bar does not fall within Chaffee County *v.* Potter, and cannot be distinguished in principle from Dixon County *v.* Field or from Lake County *v.* Graham. The only difference worthy of note is that in each of these cases the single fact required to be shown by the public record was the valuation of the property of the county. Whereas, here, two facts are to be so shown, the valuation of the property and the amount of the county debt. But, as both these facts are equally required by the statute to be entered on the public records of the county, they are both facts of which all the world is bound to take notice, and as to which, therefore, the county cannot be concluded by any recitals in the bonds."

was prohibited by the provision of the State Constitution,[1] which provides that "no county containing a city of over one hundred thousand inhabitants, or any such city, shall be allowed to become indebted for any purpose or in any manner to an amount which, including existing indebtedness, shall exceed ten per centum of the assessed valuation of the real estate of such county or city subject to taxation, as it appeared by the assessment rolls of said county or city on the last assessment for state or county taxes prior to the incurring of such indebtedness; and all indebtedness in excess of such limitation, except such as may now exist, shall be absolutely void, except as herein otherwise provided. No such county or city whose present indebtedness exceeds ten per centum of the assessed valuation of its real estate subject to taxation shall be allowed to become indebted in any further amount until such indebtedness shall be reduced within such limit. This section shall not be construed to prevent the issuing of certificates of indebtedness or revenue bonds issued in anticipation of the collection of taxes for amounts actually contained, or to be contained, in the taxes for the year when such certificates or revenue bonds are issued and payable out of taxes. Nor shall this section be construed to prevent the issue of bonds to provide for the supply of water, but the term of the bonds issued to provide for the supply of water shall not exceed twenty years, and a sinking fund shall be created on the issuing of the said bonds for their redemption, by raising annually a sum which will produce an

[1] Const. N. Y. art. 8, § 11.

amount equal to the sum of the principal and interest of said bonds at their maturity." There was a city of more than 100,000 inhabitants in this county. There was a submission of the controversy between the county treasurer and the bidder for these bonds to the Supreme Court of New York in General Term without action. The contention of the bidder was that the constitutional provision should be construed so as to take in the estimate the indebtedness of the city as well as the county in determining the then present indebtedness. The Supreme Court held that under the provision, a city and county in which it was situated might each incur debt to the extent of ten per cent of the assessed value of all the taxable real estate within it; and that the restriction provided by that section was separate and distinct as to each.[1] A case in the federal court for the western district of Iowa involving the validity of certain refunding bonds of a

[1] Adams *v.* East River Savings Institution, (1892) 47 N. Y. St. Repr. 175, holding the bonds valid and authorized and rendering judgment against the bidder. Affirmed in 136 N. Y. 52. The reasoning of the Supreme Court, as to the construction of this provision of the Constitution of New York was approved by the Court of Appeals. CULLEN, J., for the Supreme Court, said: "The first question is, whether the water debt is to be counted in determining whether the ten per cent limit of a city has been reached or exceeded. We think it is. The constitutional provision is that no county or city shall for any purpose go beyond the prescribed percentage. * * * [It is contended] for the defendant that it was the intent of this constitutional provision to restrain the creation of debt either by the city or county which, taken together, would exceed ten per cent of the assessed value of the real estate lying within the county or city; or, in other words, that real estate should not bear the burden of a greater debt both for city and county purposes than ten per cent of its assessed value. * * * 'If the language is unambiguous, the words plain and clear, conveying a distinct idea, there is no occasion to resort to other means of interpretation. Effect must be given to the intent as indicated by the language employed. Especially should this be so in the interpretation of a written Constitution framed deliberately and with care and adopted by the people as the organic law.' Settle *v.* Van Evrea, 49 N. Y. 280. This rule is peculiarly applicable to the case in hand, for the case is singularly barren of external sources from which to draw light. The limit prescribed by the Constitution is wholly arbitrary, and necessarily so. While most citizens would recognize that excessive debts by localities is an evil to be checked, the question of what debt is excessive would produce the widest diversities of opinion; diversities to be composed only by compromise at an arbitrary figure. This is the first provision of the character in any of the Constitutions of this state; so we are equally without tradition or policy in this respect. We must, therefore, decide the case in the very words of the Constitution. The language of the Constitution is disjunctive, 'No county, * * * or any such city, shall be allowed to become indebted to an amount which shall exceed ten per cent of the assessed value of the real estate of such county or city subject to taxation.' The literal and grammatical reading is that the county shall not be allowed to incur debt beyond a certain per cent, and that the city shall not be allowed to incur debt beyond the same per cent. Separate restrictions are imposed on each. This is so clear to my mind as to forbid elaboration."

county which had been purchased in good faith, and for a full consideration, by the plaintiff and other purchasers, raised several questions as to refunding bonds. There was abundant evidence to show that the amount received for the bonds was applied by the county through its refunding agent to the payment of bonds then outstanding against the county; also, that the amount of the bonds thus negotiated by its agent exceeded largely the constitutional limitation of five per cent upon the valuation of taxable property of the county, as shown by the last preceding state and county tax lists. The county resisted recovery against it in this action on the ground of the bonds being in excess of the constitutional limitation. The court held that those of the series of bonds which had been issued through the refunding agent of the county, so far as they represented then existing indebtedness of the county at the time they were issued, were valid; those of the series which did not represent such existing indebtedness were held to be invalid.[1]

[1] Ætna Life Insurance Co. *v.* Lyon County, (1890) 44 Fed. Rep. 329, SHIRAS, J., said, generally, as to the bonds: "If this issue of bonds had been negotiated in the purchase of property then acquired, or for the erection of county buildings or other like purposes, so that thereby a new or original indebtedness had been thereby created against the county, there could then be no question that the bonds themselves would be void by reason of the provision of the Constitution of the state of Iowa, limiting the indebtedness of all municipal and political corporations within the state to five per cent upon the taxable property within the limits of the particular corporation; and a recovery thereon could not be had, even in favor of parties who had paid full value therefor in the belief that the bonds were valid. Buchanan *v.* Litchfield, 102 U. S. 278; Dixon County *v.* Field, 111 U. S. 83; s. c., 4 Sup. Ct. Rep. 315; Lake County *v.* Rollins, 130 U. S. 662; s. c., 9 Sup. Ct. Rep. 651; Lake Co. *v.* Graham, 130 U. S. 674; s. c., 9 Sup. Ct. Rep. 654. The bonds in question were not issued for any such purpose, but were issued for the purpose of refunding other outstanding bonds of the county; and the issuance thereof did not in fact increase the indebtedness of the county, but only the form or evidence of the indebtedness. Under these circumstances, it is broadly claimed on behalf of plaintiff that the bonds, being issued to refund or pay other bonds, are not affected by the constitutional limitation. To the extent of holding that, as applied

§ 401. The validity of judgments against a county for which the bonds were issued cannot be questioned in actions on the bonds.— It was argued in behalf of the county in this case upon coupons of the bonds that, upon the issue of unconstitutionality of the issue of the bonds, it was open to the county to question the validity of judgments against the county, or of the bonds issued to fund or pay judgments against the county. The court held that it was not open to the county to make such a defense.[1]

to a series of refunding bonds, the mere fact that the amount thereof might exceed five per cent of the then taxable valuation of the property within the county, as shown by the tax lists, would not necessarily show that the bonds so issued were invalid, I can agree in the views of counsel for plaintiff. If a county owes a valid and enforceable indebtedness, refunding bonds, issued under authority of an act of the legislature for the purpose of taking up such enforceable indebtedness, are not invalid because they may exceed the five per cent limitation. In such case the refunding bonds are valid, because they represent a valid indebtedness. Railroad Co. *v.* County of Osceola, 45 Iowa, 168; Austin *v.* District Tp. of Colony, 51 Iowa, 102. In suits, therefore, upon refunding bonds representing prior indebtedness, it is necessary, in order to sustain the defense of invalidity, to show that the indebtedness merged in and represented by the refunding bonds was itself invalid and non-enforceable either in whole or in part * * *."

[1] Ætna Life Ins. Co. *v.* Lyon County, (1890) 44 Fed. Rep. 329. SHIRAS, J., said: "The constitutional limitation is not self-acting. The protection of its provisions must be invoked at the proper time and in the proper mode. If judgments are obtained against a county, and the same are not reversed, but remain in full force, they are evidence of the highest nature that the county owes the amounts adjudged to be due; and if the county, having the power to fund its outstanding indebtedness, issues bonds in payment of such judgments, the validity of the bonds cannot be successfully attacked, when suit is brought thereon, by showing that, if the defense had been interposed in the original case, the claim might have been defeated, and that the judgment actually rendered might have been prevented. As is said by the Supreme Court in Cromwell *v.* Sac County, 94 U. S. 351: 'Thus, for example, a judgment rendered upon a promissory note is conclusive as to the validity of the instrument, and the amount due upon it, although it be subsequently alleged that perfect defenses actually existed, of which no proof was offered, such as forgery, want of consideration or payment. If such defenses were not presented in the action, and established by competent evidence, the subsequent allegation, if then in existence, is of no legal consequence. The judgment is as conclusive, so far as future proceedings of law are concerned, as though the defenses never existed.' The argument of counsel would have weight if the constitutional provision was to the effect that no judgment could be rendered against a county under any circumstances. In such case, even though a court should enter up a judgment, its unconstitutionality and in

§ 402. The statements of a county's agent in sale of bonds not operative as an estoppel upon the county to defend.— It has been held in a case in the federal court in one of the districts of Iowa that the statements made by the refunding agent of a county in negotiating the sale of certain refunding bonds, which had been issued by a county of that state, did not operate as an estoppel against the county; that it was open to the county to show that the bonds merged into the refunding bonds sold by its agent were in whole or in part invalid and non-enforceable.[1]

validity would be self-apparent, and could always be availed of when its enforcement might be attempted, and this for the reason that upon its face the judgment would show that the court was without jurisdiction. A defense based upon the clause limiting the amount of municipal indebtedness to five per cent upon the amount of taxable property is of a wholly different nature. It requires a proper pleading of the facts, and upon the trial proper evidence must be introduced or else the defense fails. It makes no difference in the validity of the judgment whether the defendant failed to plead the defense based upon the constitutional limitation, or failed to sustain the defense, if pleaded, by sufficient evidence. In either case the rendition of the judgment established the validity of the claim against the county, and the judgment, so long as it remains unreversed, cannot be questioned on the ground that the amount thereof exceeds five per cent of the taxable property of the county."

[1] Ætna Life Insurance Co. *v.* Lyon County, (1890) 44 Fed. Rep. 329. *Arguendo*, it was said by SHIRAS, J.: "When these bonds were offered to the plaintiff it was known to the parties acting for the plaintiff that the series of bonds proposed to be negotiated exceeded in amount five per cent of the taxable property in the county, and, therefore, to authorize the issuance thereof, there must be then in existence a valid indebtedness to the amount of one hundred and twenty thousand dollars, which it was proposed to refund by the issuance of the bonds in question. The validity of the bonds was asserted upon the claim that the bonds to be refunded represented claims that had been reduced to judgment, and, therefore, were enforceable against the county. The purchasers knew, and were bound to know, that unless the assertion was true, the bonds would be invalid, because in excess of the constitutional limitation, and the purchasers were bound to ascertain what the fact in this particular was. The bonds themselves contain no recital on the subject. The certified copy of the proceedings taken by the board of supervisors in regard to the issuance of the bonds, and which copy was submitted to the purchasers, does not contain any statement showing that the bonds proposed to be refunded were based wholly upon prior judgments. The statement relied upon as an estoppel was made by [the refunding agent] first orally and then in the form of an affidavit; but he was not then acting on behalf of the county in ascertaining or certifying to a fact which the law required to be then ascertained and determined as the basis for further action. He was the refunding agent of the county, but he did not have the power to determine any question or matter pertaining to the right to issue the bonds. Dixon Co.

§ 403. When a county may plead an overissue.— The United States Circuit Court of Appeals has held in a late case that one who bought municipal bonds at one time in such number as to exceed in amount the limit of the issue authorized by law (being an amount capable of liquidation in a certain time at a given rate of taxation, based on the assessment rolls), was chargeable with notice, and the municipality was not estopped to plead an overissue.[1]

v. Field, 111 U. S. 83; s. c., 4 Sup. Ct. Rep. 315; Daviess Co. *v.* Dickinson, 117 U. S. 657; s. c., 6 Sup. Ct. Rep. 897. The resolution of the board of supervisors appointing [him] declares the object of the appointment to be 'for the purpose of funding and refunding the county indebtedness,' and the resolutions adopted by the board * * * show upon their face that it was the purpose of the board to undertake the bonding of the floating indebtedness, as well as the refunding the then outstanding bonded indebtedness. Upon the question of what the bonds proposed to be refunded were the representative, and whether the same were based upon judgments presumably rendered against the county, the records of the county constituted the primary and best evidence. [The refunding agent] had no charge over or connection with these records, nor was he the one to whom application would naturally be made by one seeking to know the origin and purpose of the outstanding bonded indebtedness of the county. If the effect of an estoppel is given to statements of this character, the protection intended to be secured by the constitutional provision limiting the amount of indebtedness of counties and other municipal corporations would be wholly destroyed. In every instance it could be evaded by the simple device of appointing a refunding agent, and by his statements create an estoppel against the county or city, and thus validate any amount of bonds that might be issued."

[1] Francis *v.* Howard County, (1893) 54 Fed. Rep. 487, affirming Francis *v.* Howard County, (1892) 50 Fed. Rep. 44, in which case MAXEY, D. J., fully discusses the questions involved. *Arguendo*, PARDEE, Circuit Judge, said: "It is contended that the recital in each bond that 'this bond is issued in accordance with the provisions of the act of the legislature of Texas, entitled 'An act to authorize the County Commissioners' Court of the several counties of this state to issue bonds for the erection of a court house, and to levy a tax to pay for the same,' approved February 11, 1881,' is a recital of the performance of a condition precedent, on the part of the County Commissioners' Court, to wit, that the amount of the same was within the limits allowed by the act of 1881, and that a purchaser of the bonds was not bound to inquire, the case being within the principles declared in Marcy *v.* Oswego, 92 U. S. 637; School Dist. *v.* Stone, 106 U. S. 183; s. c., 1 Sup. Ct. Rep. 84, and cases there cited; and particularly in Chaffee County *v.* Potter, 142 U. S. 355; s. c., 12 Sup. Ct. Rep. 216. In the last-mentioned case it was held: 'When there is an express recital upon the face of a municipal bond that the limit of issue prescribed by the State Constitution has not been passed, and the bonds themselves did not show that it had, the holder is not bound to look further.' The answer

§ 404. When the defense that a county was not fully organized when the bonds were issued is not open to the courts.— The United States Supreme Court, in a case involving coupons of bonds issued by a Kansas county for the purpose of building a bridge and court house, held that in that state a county had power to borrow money for such purposes and to issue bonds therefor. Further, it was ruled that when both the executive and legislative departments of the state had given notice to the world that a county within the terrritorial limits of that state had been duly organized and existed, with full power of contracting, it was not open to the courts to dispute those facts in an action brought against it by a holder of its bonds, who bought them in good faith in open market. The debts of a county, contracted during a valid organization, remain the obligations of the county, although for a time the organization may be abandoned, and there be no officers to be reached by the process of the court. Further, a recital in a bond of a municipal corporation in Kansas that it was issued in accordance with authority conferred by the act of March 2, 1872 (Kansas Laws, 1872, 110, chap. 68), and in accordance with a vote of the majority of the qualified voters, was held sufficient to validate the bonds in the hands of a *bona fide* holder; and the certificate of the auditor of the state thereon that the bond was regularly issued; that the signatures were genuine, and that the bond had been duly registered, was conclusive upon the municipality. Also, a recital on a bond issued by a county in Kansas for the purpose of building a bridge, need not necessarily refer to the particular bridge for the construction of which it was

to this contention of the plaintiff in error is that the recital in the bonds sued on is not a recital of facts so much as of a conclusion of law; that the bonds contain no express recital of the existence of any fact, and that a fair construction of the act of 1881 leaves the ascertainment of no fact to be found by the County Commissioners' Court as a condition precedent to the issue of bonds themselves, but practically leaves the County Commissioners' Court and all purchasers and holders of bonds to act at their peril. All of the decisions of the Supreme Court of the United States, from Dixon Co. *v.* Field, 111 U. S. 83; s. c., 4 Sup. Ct. Rep. 315, to Sutliff *v.* Board, 147 U. S. 230; s. c., 13 Sup. Ct. Rep. 318, agree that the purchasers of bonds issued by municipalities under authority of laws which limit the amount of bonds to be issued to a certain percentage of the assessment rolls, or to a given rate of taxation based on such rolls, are charged with notice of the assessment rolls, and of the amount of bonds which can be validly issued, based on such assessment rolls."

issued.[1] In a late case before the United States Circuit Court of Appeals it appeared that after the organization of a new county in Michigan, under an act of the legislature of 1871, its board of supervisors determined that it required a certain amount of money to erect a court house and jail, and, after a vote of the citizens in favor of it, raised the amount by issuing county bonds and selling them to *bona fide* purchasers for value. These bonds were afterwards paid in part and reduced to judgment in part by the holders. The money raised by the sale of these bonds had been used for the purposes of erecting the county court house and the jail, and the latter used for the purposes of the county. In 1875 another act was passed organizing the county. In 1885 an act was passed which authorized the refunding of outstanding bonds of the county, and the bonds originally issued and judgments upon such as had been sued were surrendered by the holder and these refunding bonds given in exchange. Upon the latter bonds this action was brought, and the Circuit Court, presumably upon its idea of the effect of a decision of the state Supreme Court in a certain case, upon the defense that the county was not organized as the Constitution of the state required, directed a judgment in favor of the county. The United States Court of Appeals reversed the Circuit Court, and held the bonds for which these refunding bonds were exchanged to have been valid obligations of the county.[2]

[1] Comanche County *v.* Lewis, (1890) 133 U. S. 198, affirming Lewis *v.* Comanche County, 35 Fed. Rep. 343. As supporting the third point, see State ex rel. *v.* Yoxall, 40 Kans. 323; Broughton *v.* Pensacola, 93 U. S. 266; Mount Pleasant *v.* Beckwith, 100 U. S. 514. As to the effect of the recitals, see School District *v.* Stone, 106 U. S. 183; Lewis *v.* Commissioners, 105 U. S. 739. As to the power of Kansas counties to borrow money and issue bonds, see Leavenworth County *v.* Miller, 7 Kans. 479; Doty *v.* Ellsbree, 11 Kans. 209.

[2] Ashley *v.* Board of Supervisors of Presque Isle County, (1893) 60 Fed. Rep. 55. It was said by the court: "We do not consider the act of 1875 as in any sense a repudiation of the original organization. Doubts had arisen in regard to its legality. The public interests required that those doubts should be put at rest, and the legislature proceeded to clothe the county with an unquestionable title. Having regard to what transpired, it would seem that the statute should be regarded as effecting a reorganization and giving express sanction for the continuance of a body whose origin was clouded with doubts of its lawfulness. However that might be, the statute could not, upon any construction, operate to divest rights which had been acquired while the county was exercising the powers it had assumed."

§ 405. Counties suable in federal courts.— It was claimed in an action upon the bond of a county in Nevada that because a county was an integral part of the state it could not, under the eleventh amendment of the Federal Constitution, be sued in the United States Circuit Court; also, that inasmuch as the act under which the bonds were issued provided for litigation concerning the court, and named the court of the state in which such litigation could be had, that such jurisdiction was exclusive, and prevented suit in the Circuit Court. The United States Supreme Court held adversely to both of these contentions.[1]

§ 406. Plea of Statute of Limitations on county bonds.— In this action upon bonds of a county in Nevada the county

[1] Lincoln County *v.* Luning, (1890) 133 U. S. 529. Mr. Justice BREWER, speaking for the court, said: "With regard to the first objection, it may be observed that the records of this court for the last thirty years are full of suits against counties, and it would seem as though by general consent the jurisdiction of the federal courts in such suits had become established. But irrespective of this general acquiescence, the jurisdiction of the Circuit Courts is beyond question. The eleventh amendment limits the jurisdiction only as to suits against a state. It was said by Chief Justice MARSHALL, in Osborn *v.* Bank of the United States, 9 Wheat. 738, 857, that the 'eleventh amendment, while restraining the jurisdiction granted by the Constitution over suits against states, is of necessity limited to those suits in which the state is a party on the record. While that statement was held by this court in the case of In re Ayers, 123 U. S. 443, to be too narrow, yet by that decision the jurisdiction was limited only in respect to those cases in which the state is a real, if not a nominal defendant; and while the county is territorially a part of the state, yet politically it is also a corporation created by and with such powers as are given to it by the state. In this respect it is a part of the state only in that remote sense in which any city, town, or other municipal corporation may be said to be a part of the state. Metropolitan Railroad Co. *v.* District of Columbia, 132 U. S. 1. * * * With regard to the other objection, the case of Cowles *v.* Mercer County, 7 Wall. 118, 122, is decisive. In that case the court, by the chief justice, expressed its opinion on the very question in these words: 'But it was argued that counties in Illinois, by the law of their organization, were exempted from suit elsewhere than in the Circuit Courts of the county. And this seems to be the construction given to the statutes concerning counties by the Supreme Court of Illinois. But that court has never decided that a county in Illinois is exempted from liability to suit in national courts. It is unnecessary, therefore, to consider what would be the effect of such a decision. It is enough for this case that we find the board of supervisors to be a corporation authorized to contract for the county. The power to contract with citizens of other states implies liability to suits by citizens of other states, and no statute limitation of suability can defeat a jurisdiction given by the Constitution.'"

attempted to avail itself of the Statute of Limitations. The United States Supreme Court held that when, after default by a municipal corporation in the payment of interest upon its bonds, the legislature provides for the creation of a special fund by the debtor out of which the creditor is to be paid, the debtor cannot set up the Statute of Limitations to an action on the bonds and coupons without showing that the fund had been provided.[1]

§ 407. When statute as to presentation of claims is not applicable to judgments upon bonds and coupons.—The statute of Nevada requiring presentation of claims and accounts against counties to the county commissioners and county auditor

[1] Lincoln County *v.* Luning, (1890) 133 U. S. 529. The bonds in this case had been issued in 1873. In 1877 the county was delinquent in its interest, and there was an amendatory act passed providing for the registration of overdue coupons and imposing upon the treasurer the duty of thereafter paying the company as money came into his possession applicable thereto. It was said by the court: "The coupons, which by the General Limitation Law would have been barred, were presented as they fell due to the treasurer for payment and payment demanded and refused because the interest fund was exhausted. Thereupon the treasurer registered them as presented in accordance with the act of 1877, and from the time of their registration to the commencement of this suit there was no money in the treasury applicable to their payment. This act, providing for registration and for payment in a particular order, was a new provision for the payment of these bonds, which was accepted by the creditor and created a new right upon which he might rely. It provided, as it were, a special trust fund to which the coupon holder might, in the order of registration, look for payment and for payment through which he might safely wait. It amounted to a promise on the part of the county to pay such coupons as were registered in the order of their registration as fast as money came into the interest fund; and such promise was by the creditor accepted. * * * The cases of Underhill *v.* Sonora, 17 Cal. 173, and Freehill *v.* Chamberlain, 65 Cal. 603, are in point. In the former case the court observes that 'the legislative acts then recognized the debt and made provision for its payment. This is enough to withdraw the case from the operation of the statute; it is equivalent to a trust deed by the state setting apart property out of which the money due was to be paid at a given time, if not sooner paid upon a claim acknowledged to be an outstanding debt; and we cannot conceive of any principle of law or justice which would hold the claim to be barred by the statute simply because the creditor waited after this for his money.' In the other case it was held that 'where a statute provides for the issuing of bonds of a city with interest coupons payable as fast as money should come into the treasury from special sources designated by the act, the Statute of Limitations does not commence to run against the coupons until the money is received in the treasury in accordance with the terms of the act.'"

for allowance and approval has been held by the federal court for that district to apply only to unliquidated claims and accounts, not to bonds and coupons, nor to a judgment upon bonds and coupons. Neither is such presentation necessary before an action on such a judgment. It was further held that where the statute authorizing bonds to be issued provides for their payment by levying a special tax and creating a special fund, an allowance by a county board and audit of a claim on a judgment on such bonds as payable out of the general fund, would not be an allowance in the manner and form to which the holder would be entitled; nor would he be precluded from maintaining an action on the judgment because of another remedy prescribed by statute to enforce payment of claims allowed and audited.[1]

§ 408. The proper proceeding of courts where some of the bonds of a series are valid and others invalid.—A corporation holding certain of a series of refunding bonds issued by a county in Iowa, having brought its action at law in the federal court of one of the districts of that state, and the court holding some of the bonds of the series valid and some invalid, the court was compelled to order judgment in favor of the county because it was not possible in the action to settle the equities of the different holders of these bonds. The judgment was, however,

[1] Vincent *v.* Lincoln Co., (1894) 62 Fed. Rep. 705. The court said: "The judgment originally obtained in this case and upon which this action is brought is conclusive that the bonds and coupons upon which the judgment was rendered were binding obligations, which entitled plaintiff to payment of the same out of the fund created by law for that purpose or out of any fund that could be lawfully created for the payment of the same. And it is not within the power of the board to limit this right so as to deprive plaintiff of the remedy to which he is entitled under the law. Ralls Co. Court *v.* U. S., 105 U. S. 733, and note; Lincoln Co. Court *v.* U. S., 105 U. S. 739, note." That the complaint on coupons and bonds of a county is not defective for not showing that they had been presented to the county commissioners and county auditor for allowance and approval as provided in statutes of the state, see County of Greene *v.* Daniel, 102 U. S. 187, 194, in which the court observed, speaking of bond and coupons, that "the claim was, to all intents and purposes, audited by the court when the bonds were issued. The validity and the amount of the liability were then definitely fixed and warrants on the treasury given, payable at a future day." As to the constitutionality of the statute of Nevada authorizing the issue of certain county bonds, see Odd Fellows' Bank *v.* Quillen, 11 Nev. 109, following Youngs *v.* Hall, 9 Nev. 212; approved and followed in Lincoln County *v.* Luning, (1890) 133 U. S. 529, 532.

without prejudice to the plaintiff, leaving it in its power to bring an action of equity to settle the equities of the holders, which the court recognized. As to the inability of the court at law, SHIRAS, J., said: "It is argued that the bonds would be valid until the amount needed to refund the enforceable debt had been reached, and that it will be presumed that the bonds were sold in the order of their number. Such a presumption cannot be indulged in under the facts of this case. To settle the equities and rights of the bondholders against the county and their rights as between themselves would seem to require the institution of a suit in equity. In this action at law between one owner of part of the bonds and the county, it is beyond the power of the court to hear and determine the question of the order in which the series of bonds were sold or the application of the proceeds realized from the sales thereof, and whether the facts are such that a certain number of the bonds can be held valid at law, or whether it should not be held that each owner of a bond is equitably entitled to demand his share of the total sum which may be adjudged to be collectible from the county." He suggested the following as a proceeding proper in such a case: "It seems to me that the only means of solving the difficulties of the situation is for the plaintiff and the other non-resident bondholders to unite in a proper proceeding in equity against the county and such other bondholders as may refuse to act as complainants, and in such suit it can finally be determined for what amount the county can be held liable and the rights of the respective bondholders in and to this sum can be decreed."[1]

[1] Ætna Life Insurance Co. *v.* Lyon County, (1890) 44 Fed. Rep. 329, 345.

CHAPTER XIX.

CITY BONDS.

§ 409. City bonds generally.
410. Extension of a bonded debt of a city.
411. Bonds for funding indebtedness.
412. Effect of a statutory limitation on bonds.
413. Bonds in compromise of outstanding indebtedness.
414. The effect of a statute legalizing an issue of bonds.
415. Bonds for public improvements—limitations on power to issue.
§ 416. Effect of an order by resolution of council of a city for an election to authorize the issue of bonds.
417. Bonds valid when issued as a part of the general indebtedness of a city.
418. Validity of bonds as affected by a restriction in the charter of a city.

§ 409. City bonds generally.— The weight of authority upon the power of a municipal corporation to execute bonds, to be placed on the market for the purpose of raising money to be expended by the agents of the corporation, or for the purpose of funding outstanding indebtedness, seems to be generally against the exercise of the power except in cases where the power is derived from legislative authority, expressed or implied. The reason for the ruling is well known to be in the fact that municipal corporations are established to enable the people residing in towns and cities to have the benefits of local government. Unlike trading or business corporations, their powers, unless otherwise directed by express or implied grant, should be, and are, in law as well as in public policy, limited to such as are governmental or administrative in their nature and scope, to such as are necessary to conserve the purposes of their organism.[1] Where a city had power to borrow money to assist in construction of certain improvements, and did so borrow, but a portion of the sum was misappropriated, the Indiana Supreme Court held that the city had power to borrow an additional amount by issuance of bonds to pay the residue of the debts unpaid.[2] Municipal bonds, in the absence of statutory authority, can only be payable at the municipal treasury.[3] The Indiana statute conferring on cities the

[1] Holmes *v.* City of Shreveport, (1887) 31 Fed. Rep. 113.

[2] Daily *v.* City of Columbus, 49 Ind. 169.

[3] Sherlock *v.* Village of Winnetka, 68 Ill. 530.

general power, without restriction, to purchase real estate for the purpose of constructing buildings thereon, has been held to give by implication the exclusive right to determine the expediency of the purpose, the power to purchase on credit and to issue necessary bonds for the purchase money.[1] A city will not be prevented from issuing new bonds with coupons for future interest, for the purpose of funding debts, with accrued interest, existing prior to the adoption of a constitutional provision prohibiting municipal corporations from becoming indebted to an amount in the aggregate exceeding two per centum on the value of their taxable property by such provision.[2] A citizen and taxpayer of a city may by injunction prevent the issue of negotiable bonds which *bona fide* holders might enforce, and, where they have been issued, but remain in the hands of one who received them with notice, may maintain a suit to restrain their transfer, and for their surrender and cancellation.[3] A city authorized to issue a bond for its indebtedness, the Supreme Court of Illinois held was authorized to issue another bond upon terms as to interest within the limitations of its charter in that respect, upon the coming due of the first bond issued, for the time extended, and take up the old one therewith.[4] The onus of showing that bonds issued by a municipal corporation are illegal is on the one who seeks to impeach them.[5] A *bona fide* holder of bonds of a municipal corporation, where the corporation has power under any circumstances to issue negotiable securities, has a right to presume that they were issued under circumstances giving the requisite authority, and such bonds are no more liable to be impeached in the hands of such a holder than any other commercial paper.[6] An innocent holder, acquiring municipal bonds, without collusion, for a valuable consideration, will not be prejudiced by irregularities in their issue where he had no knowledge of such irregularities.[7] The defense that one is the *bona fide* holder may be set up when bonds are made negotiable, or when coupons are detached from

[1] City of Richmond *v.* McGirr, 78 Ind. 192.

[2] Powell *v.* City of Madison, 107 Ind. 106.

[3] City of Madison *v.* Smith, 83 Ind. 502. As to the power of Kansas cities to issue bonds in payment of the building of sidewalks, see Wyandotte *v.* Zeitz, 21 Kans. 649.

[4] City of Quincy *v.* Warfield, (1861) 25 Ill. 320.

[5] Ibid.

[6] Gelpcke *v.* Dubuque, 1 Wall. 175.

[7] State *v.* City Council, 74 Ala. 226; Burr *v.* City of Carbondale, 76 Ill. 455; Town of Douglas *v.* Niantic Savings Bank, 97 Ill. 228.

the bonds, the coupons being negotiable.[1] An act authorizing the issue of bonds of a city in Alabama for the construction of a canal, etc., declared that "No bond shall be issued but upon an entire concurrence of the board of mayor and aldermen, upon a full attendance of all the members of the board, and when there is no vacancy, which shall be made manifest only by an entry of the order for issuing being made on the minutes of the board, and signed by each member thereof; nor shall any contract amounting to one hundred dollars, made under any of the provisions of this act, be valid, which is not made under all the restrictions in this section recited." This restriction was held to continue under an act subsequently passed extending the amount and authorizing the money to be appropriated under the supervision of the mayor and aldermen "for any purpose of internal improvement for the benefit of the citizens of [the city]." And a purchaser of a bond issued under this last act, and reciting on its face that it was so issued, was held chargeable with notice of the restrictions and conditions and not entitled to claim protection as an innocent holder, although the bond also recited that it was issued in conformity with the statute.[2] A clause in the charter of an Illinois city empowering the city council to borrow money not exceeding $100,000, and issue bonds therefor, has been held to apply to the incurring of liabilities by borrowing money and not to those incurred as a part of the current expenses of the city.[3] A third person liable to pay to a municipal corporation the indebtedness, for instance, a judgment for which the corporation has issued bonds in payment of in favor of the judgment creditor, cannot set up the fact that the bonds were invalid by reason of being in excess of the constitutional limit of indebtedness.[4] The existing legal power or authority to issue municipal bonds being defectively or irregularly executed, makes the bonds only voidable.[5] Municipal bonds

[1] Atchison *v.* Butcher, 3 Kans. 121.

[2] Mayor *v.* Wetumpka Wharf Co., 63 Ala. 611. An illustration of when the holder of coupons of bonds void as *ultra vires* the corporation to issue, cannot maintain a suit against a city treasurer for taxes levied for the payment of these coupons under an ordinance of the council of the city and coming into the hands of the treasurer. McConnell *v.* Hamm, 16 Kans. 228.

[3] Barrett *v.* City of East St. Louis, 89 Ill. 175, holding a bond issued in payment of a current liability valid, although the bonded indebtedness of the city exceeded the limitation stated in the text.

[4] Sioux City *v.* Weare, 59 Iowa, 95.

[5] Ryan *v.* Lynch, 68 Ill. 160.

merely voidable may be enforced in the hands of an innocent purchaser for value, but if they are absolutely void, they cannot be enforced, either by the original holder or a purchaser for value.[1] Even in the hands of an innocent holder, bonds of a municipal corporation issued without authority, are void.[2]

§ 410. Extension of a bonded debt of a city.— The question raised in a New York case was over an apparent collision between the terms of the charter of a city and the Refunding Act of 1878. The charter had in it these words of restraint upon the city: "The common council shall not have power to borrow, and is hereby expressly prohibited from borrowing, any money on account of the city, except as herein provided. The said council shall not create any pecuniary obligations whatever on the part of the city which shall not be payable in the current year, and which cannot be discharged from the income of the same year." Nevertheless a bonded debt was lawfully created to supply the city with water; not by an amendment of the charter, but by express legislative permission outside of it, granting authority to borrow money for such purpose, and that permission was given without notice of or reference to the section of the charter prohibiting a loan. FINCH, J., for the Court of Appeals, said of it: "It operated as a specific exception to an established general rule, and, so construed, the two acts could be read together without collision or contradiction." The Refunding Act, passed afterwards, authorized in two forms the extension of a bonded debt for a period not exceeding thirty years, but at a lower rate of interest. This act applied to every village, city or county owing such debt and desiring to extend it through an added period of credit. It applied to all of them without reference to their charters or the acts under which the indebtedness was created, and was an enabling act of which any city might avail itself. The two forms of extension authorized were, *first*, an exchange of old for new bonds, securing the new credit at the lower rate of interest, and, *second*, to meet the emergency of a refusal by holders to make the exchange bond for bond, the issue and sale of new bonds, applying the proceeds to the cancellation of the old ones. The city involved in this case chose the second form of extension, and the purchaser refused to take the new bonds, upon the ground that it was a borrowing of money prohibited by the charter, and the issue of the bonds by the city was unauthorized. The Court of Appeals affirmed the decree of the court below that the purchaser should specifically perform his part of the contract to purchase these bonds, holding the bonds valid and authorized.[1]

[1] Barnes *v.* Town of Lacon, 84 Ill. 461.

[2] Williamson *v.* Keokuk, 44 Iowa, 88. That bonds of municipal corporations issued without legal authority, are void even in the hands of innocent purchasers without actual notice of the want of power in the corporation to issue them, see Bissell *v.* City of Kankakee, 64 Ill. 249; Livingston County *v.* Weider, 64 Ill. 427; Town of Big Grove *v.* Wells, 65 Ill. 263; Ryan *v.* Lynch, 68 Ill. 160. As to the power of a city in Michigan to issue bonds without a vote of the electors, see Common Council of City of Muskegon *v.* Gow, (1892) 94 Mich. 453; s. c., 54 N. W. Rep. 170. As to authority to issue, see Tillotson *v.* City of Saginaw, (1892) 94 Mich. 240; s. c., 54 N. W. Rep. 162. As to city revenue bonds, see People *v.* Myers, (1893) 138 N. Y. 590.

[1] City of Poughkeepsie *v.* Quintard, (1892) 136 N. Y. 275. FINCH, J., speaking for the court, said: "It must be conceded that the transaction in form may be a borrowing of money, but in substance it is the very different case of refunding an existing debt. There is a new creditor and a new rate of interest, but the same old debt. The municipal liability is not increased, but merely suffered to remain, and not a dollar of new or added debt results. The transaction is no different from what it would have been if there had been an exchange of bonds. There it is conceded there would have been no borrowing of money, and merely an extension of credit. But the actual result and the contemplated purpose are exactly the same under the second form of refunding as under the first, and I do not think the permission of the Enabling Act comes into collision with the prohibition of the charter. That prohibition had an obvious purpose and meaning. It was to restrain the creation of a debt, not the extension of one already existing; to prevent a new liability, not to postpone payment of an old one; to shield the taxpayers from the waste and danger of extravagant and needless appropriations, and not to obstruct the convenient and beneficial extension of a proper debt lawfully incurred. Full force and effect can be given to each statute by reading them together, and construing them as if they were contained in one and the same act of legislation. It is our duty to harmonize them if possible, and I can see no more reason for deeming them inconsistent and repugnant than the provision of the charter and the original act authorizing the water debt. It is true that the Refunding Act is a general act, applying to all the municipalities, and that circumstance is urged to show that it worked no repeal of the debt provision of the charter, but no repeal was necessary or intended. Here was in the Refunding Act a specific permission to do one particular thing granted to all cities and so given to [the one here], and that particular intention to allow the refunding of its maturing debt is met by the general intention manifested in the charter, not to permit any debt to be contracted at all, and in such a case, if there be inconsistency, the particular intention takes effect as an exception. Hoey *v.*

§ 411. Bonds for funding indebtedness.— A city of Missouri had authority in law to borrow money within a certain limitation as to interest, and to provide for the payment of its debts. An ordinance was passed by the council creating the office of "city fund commissioner," and it was made his duty to sell the bonds of the city for the purpose of funding or paying the indebtedness of the city, and apply the proceeds to the purchase of outstanding warrants and bonds past due, or not having more than three years to run. By this ordinance he was limited in his sales to a price not less than ninety-five cents on the dollar of the par value of five-year bonds, and ninety cents for those running ten years. Upon his report of the amount of the city's indebtedness at a certain date, and how much of it was about to mature, an ordinance was passed authorizing him "to negotiate the bonds of the city for the purpose of raising money to liquidate the city debt, for a period not exceeding fifteen years, and at a rate of discount not exceeding fifteen per cent." On the 28th of March, 1872, the general assembly of Missouri passed an act providing for the registration of bonds issued by counties, cities and incorporated towns. The city, after the passage of this act, issued bonds for the purpose of raising money to pay its interest-bearing debts and the expenses of its government, containing recitals that they were issued under the authority of the charter and the ordinance above referred to. These bonds were executed after the act of March 28, 1872, went into effect, but were antedated for the purpose of evading the provisions of that statute. Without being registered these bonds were placed by the city fund commissioner in the hands of a stock and bondbroker of character for sale. This broker

Gilroy, 129 N. Y. 132. But I do not think that the refunding provision is within the spirit or intent of the charter prohibition. The object and purpose of the latter was to prevent something entirely different in substance and effect from that which the Refunding Act permitted, and the two statutes may be read together, and each perform its proper office and accomplish its appropriate duty without necessary collision or inconsistency. Nor do we encounter difficulty in the provisions of the charter, which point out the mode of payment, and provide for the payment itself of a matured debt. They operate only when ultimate payment is required, and have no application when, by the extension of the debt, its payment is postponed in fact. What may seem payment in form is not so in truth, but a mode of substituting extended bonds for those matured, taking the form of payment solely to compel the substitution intended. I think substance would be sacrificed to form, the intention of one statute be defeated, and of the other perverted, if we should construe them as hostile and inconsistent."

sold certain of the bonds to persons who paid to the broker ninety per cent of their face value, the price in money, the purchasers being ignorant of the fact that the bonds were actually executed after the registration law went into effect, or that the recitals were not in all respects true. They bought and paid for them in good faith, believing them to be what on their face the bonds purported to be and obligatory on the city. The broker, by his agreement with the fund commissioner, retained from the money realized on the sales five per cent on the par value of the bonds sold for his services, and paid the residue to the fund commissioner, who, with the sanction of the city council, used part in the payment and redemption of matured bonds, coupons and warrants of the city, and handed over the rest to the city treasurer. The fund commissioner charged himself with eighty-five per cent of the par value of these bonds, as the sum realized by him, and it was used for city purposes. The city met the interest for a while and then repudiated the bonds. The United States Supreme Court held that the holder of the bonds could recover the money which had been paid for them; that the right of action, though the bonds were invalid, could be sustained as an action for money paid by mistake, or upon a consideration which happens to fail, or for money got through imposition.[1] A late case in the United States Circuit Court for the district of Indiana shows the following facts: The city advertised for bids for a whole or a part of a certain amount of its "refunding bonds of 1893." A firm which was the successful bidder for the whole amount deposited a sum of money in a bank and took a certificate of deposit, payable to the city officials. The money was to be returned on the completion of the purchase, and to be forfeited in case the bidders failed to complete it. The firm, discovering that a portion of the bonds were invalid, brought their action against the city and the bank to obtain a return of the

[1] Louisiana *v.* Wood, (1880) 102 U. S. 294. The court said: "The money was paid for bonds apparently well executed, when in fact they were not, because of the false date they bore. This was clearly money paid by mistake. The consideration on which the payment was made has failed, because the bonds were not in fact valid obligations of the city. And the money was got through imposition, because the city, with intent to deceive, pretended that the false date the bonds bore was the true one. While, therefore, the bonds cannot be enforced because defectively executed, the money paid for them may be recovered back."

certificate of deposit and a decree entitling them to the money. A section of the charter was in these words: "The common council shall have power to authorize the issue and sale of refunding bonds in order to raise money to take up any outstanding bonds of said city, or to exchange with the holders of such outstanding bonds. The same shall be governed by the provisions of the second preceding section, so far as the same are applicable." "In view of the language of section 33," said the court, "there is no room for doubt in regard to the securities embraced in the words 'refunding bonds.' The language of the statute contains its own interpretation. Refunding bonds are of two sorts: *First*, those which are issued and sold to raise money to take up outstanding bonds of the city, or, *second*, those which are issued by the city to the holders of its outstanding bonds in exchange therefor. By the express terms of the statute refunding bonds cannot lawfully be issued for any other purpose. Six hundred of the bonds * * * awarded to the complainants were to be issued and sold to raise money to pay off and take up a like amount of the outstanding bonds of the city. To this extent and for this purpose the city had the undoubted authority to issue and sell its bonds."[1] It was held, however, that the bonds to the amount of $21,000 included in the issue over and above the $600,000 which were issued for the purpose of replacing in the general treasury of the city, which had been long before paid out in extinguishment of a series of bonds issued for the purchase of a farm, were not refunding bonds, and, therefore, not within the terms of the complainants' bid nor the city's award; that these bonds, as refunding bonds, were *ultra vires* and void, and a decree was ordered in favor of the complainants on the ground that they were entitled to stand upon the terms of their bid and entitled to a series of bonds issued solely as refunding bonds.[2]

§ 412. **Effect of a statutory limitation on bonds.**— A city of New York of more than 100,000 inhabitants was authorized by the legislature to issue bonds not to exceed a certain amount at a rate of interest not greater than four per cent and payable in not more than fifty years, in order with the proceeds to improve and extend its water supply. The city issued a part of the authorized bonds and put them on the market at public sale to the highest bidder.

[1] Coffin *v.* City of Indianapolis, (1894) 59 Fed. Rep. 221.

[2] Ibid.

One purchaser refused to accept and pay for the bonds he had bid for, upon the ground that the city could not, under the constitutional restrictions, issue the bonds redeemable in fifty years, which was the term of credit stipulated, but was confined to an issue running but twenty years and accompanied by a sinking fund sufficient to extinguish the debt at its maturity. In an action by the city against the purchaser, the New York Court of Appeals affirmed the judgment in favor of the city, sustaining the validity of the bonds as issued.[1]

[1] City of Rochester *v.* Quintard, (1892) 136 N. Y. 221, affirming 65 Hun, 460; See, also, Sweet *v.* City of Syracuse, 129 N. Y. 316. Cases holding the bonds of the city valid commercial securities: Holmes *v.* City of Shreveport, 31 Fed. Rep. 113; Dorian *v.* City of Shreveport, 28 Fed. Rep. 287; Oubre *v.* Donaldsonville, 33 La. Ann. 386; Reynolds *v.* Shreveport, 13 La. Ann. 426; City of Austin *v.* Nalle, (1893) 85 Tex. 520; s. c., 22 S. W. Rep. 668; De Mattos *v.* City of New Whatcom, (1892) 4 Wash. St. 127. In Portsmouth Savings Bank *v.* Village of Ashley, (1892) 91 Mich. 670, steps had been taken under the statute authorizing the issue of water works bonds for such an issue; after the vote of the citizens upon the question a series of bonds were signed by the president and clerk of the village, and placed in the hands of the president of a railroad company, as appeared in the action, for sale by him, the proceeds to be used for the benefit of the railroad company in consideration of an agreement to complete the road to the village. The bonds not being of a good appearance, another set of bonds were issued in their stead, the interest being made payable at a bank, so as to render them more salable. They were then sold to a bank which brought this action upon coupons of the bonds, claiming to be a *bona fide* purchaser. The Supreme Court of the state held that the statute of Michigan, with reference to the issue of water works bonds, vested the power in the village council, and until that body had met in a legal meeting and voted to issue the bonds, or authorized their issuance, one of the essential requirements of the statute had not been complied with; and that a resolution of the village council, authorizing the president and clerk to sign water works bonds, conferred no authority upon those officers to issue and dispose of the bonds, and if issued and disposed of without such authority, they were not binding on the village. See, on the subject of the right of holders of bonds in such cases, Brown *v.* Bon Homme County, (S. D.) 46 N. W. Rep. 173; Coler *v.* Cleburne, 131 U. S. 162; Bank *v.* Bergen County, 115 U. S. 384; Ledwich *v.* McKim, 53 N. Y. 315; McGarrahan *v.* Mining Co., 96 U. S. 316. As to the rights of a holder of bonds to stand in the place of the party to whom they were issued and recover, though the security may be invalid upon a count for money had and received or for money paid by mistake, see People *v.* Supervisors, 11 Cal. 170; Sturtevant *v.* Liberty, 46 Me. 457; Smith *v.* Cheshire, 13 Gray, 318; Brewster *v.* Hyde, 7 N. H. 208; Moore *v.* Sinks, 2 Ind. 257; Inhabitants, etc., *v.* Weir, 9 Ind. 224; Willim *v.* Bernheimer, 5 Minn. 290; Simms *v.* Hervey, 19 Iowa, 288; Wood *v.* Louisiana, 2 Dill. 122; Gause *v.* Clarksville, 5 Dill. 180; Paul *v.* City of Kenosha, 22 Wis.

§ 413. Bonds in compromise of outstanding indebtedness. — Upon the bonds issued by a Kansas city of the second class there were recitals to this effect: "That they were executed and issued by the city to compromise and refund its matured and maturing indebtedness heretofore legally created by said city and in accordance with the above-named act of 1879 [the act which authorized a refunding of the city's indebtedness]." "And it is hereby certified that the total amount of this issue of bonds does not exceed the actual amount of the outstanding indebtedness of said city, and that all the requirements of the provisions of the foregoing act have been strictly complied with in issuing this bond." They were signed by the mayor, and attested by the city clerk under the seal of the city. The federal court for the district of Kansas, in an action upon the bonds, held that under the provisions of the Kansas statute, that the powers granted to such cities "shall be exercised by the mayor and council of such cities," and which directs that funding bonds shall be duly issued only after an ordinance therefor shall be duly passed, these bonds which had been issued without any ordinance or resolution of the mayor and council, were void. Neither was the city estopped by the recital in the bonds to the effect that all the requirements of the statutes had been strictly complied with from denying their validity.[1]

266; Wilkinson *v.* Babbitt, 4 Dill. 208; Oneida Bank *v.* Ontario Bank, 21 N. Y. 490.

[1] Swan *v.* City of Arkansas City, (1894) 61 Fed. Rep. 478. In the opinion, the holders were considered innocent holders of the bonds, with all the rights of such, under the authority of Porter *v.* Steel Co., 122 U. S. 267; s. c., 7 Sup. Ct. Rep. 1206; Scotland Co. *v.* Hill, 132 U. S. 107; s. c., 10 Sup. Ct. Rep. 26, and it was said: "Plaintiffs are, therefore, entitled to all the protection which the law gives to holders of this class of securities, who purchased them without notice and for value. Since the decision of the Supreme Court in the Knox Co. Case, 21 How. 539, it is the settled doctrine of the United States courts that, in an action on municipal bonds by an innocent holder, the municipality will be estopped to deny the truth of all recitals contained in the bonds which the officers issuing them were, by law, to determine before issuing the bonds. But this does not affect the power of the corporation or its officers to issue the bonds. No recitals can estop the municipality from pleading a want of power to issue the bonds, for the reason that municipalities and the officers thereof are but agents with limited powers, and their authority to act must be found in the public acts, and will not be presumed to exist. * * *" The plaintiffs urged that the recitals, "that all the requirements of the provisions of the act have been strictly complied with in issuing them," makes it unnecessary for a purchaser to examine the public records of the city

§ 414. The effect of a statute legalizing an issue of bonds. — The bonds of a city of Nebraska issued to raise money to erect a high school building, being in excess of the amount which the city, by the then existing legislation, was authorized to issue, were legalized by an act of the legislature subsequently passed. In an action by a holder, upon coupons detached from the bonds due and unpaid, it was contended that the act legalizing the bonds, by legalizing bonds void because the city had no power to issue them, was, in law, equivalent to an act conferring upon the city power to issue bonds, which was conferring corporate power, and being a special act was, therefore, unconstitutional. The United States Supreme Court held the bonds to be valid obligations of the city through the operations of the act legalizing them, sustaining its constitutionality.[1]

for the purpose of ascertaining whether the mayor had been duly authorized to issue the bonds; that it is within the power of the mayor to pass upon that fact, and the issuance of the bonds by him is conclusive that the power existed. To this the judge said: "I cannot give my assent to this proposition, nor do any of the cases cited by the diligent counsel go to that extent. The decisions of United States Circuit Court of Appeals for the eighth circuit are conclusive on this court, and National Bank of Commerce *v.* Town of Granada, 10 U. S. App. 692; 4 C. C. A. 212; 54 Fed. Rep. 100, is decisive of this case. In that case the court says: 'The plaintiff was bound to know, independently of the recitals in the bond, that there was such an ordinance in existence. If the officers authorized to issue the bonds upon a condition are not the appointed tribunal to decide the fact which constitutes the condition, their recital will not be accepted as a substitute for proof. The very ground of the estoppel is that the recitals are the official statement of those to whom the law refers the public for authentic information on the subject.'"

[1] Read *v.* Plattsmouth, (1882) 107 U. S. 568. Mr. Justice MATTHEWS, speaking for the court, said: "The act in question, so far as it relates to the bonds in suit, does not confer any corporate power upon the city in the sense of the Constitution of the state. The statute operates upon the transaction itself, which had already previously been consummated, and seeks to give it a character different in its legal aspect from that which it had when it was *in fieri*. Whether such an effect may be given by a legitimate exercise of legislative power, depends upon those considerations which draw the line beyond which retroactive laws cannot pass, and is not affected by the supposed form of the contract as a special or general act conferring corporate power. For it operates upon the rights of the parties as determined by the equity of their circumstances and relations, and gives to them the sanction derived from subsequent confirmation by clothing them with powers which are essential to their enforcement but not to their existence. Within the usual limitations prescribed by our written Constitutions, such as have been quoted from that of Ne-

§ 415. Bonds for public improvements — limitations on power to issue.— As to the power of a city of Texas, the Constitution of which state contains a provision that no city shall ever incur a debt for any purpose, or in any manner, unless at the same time provision is made for levying and collecting a tax sufficient to pay the interest, and a sinking fund of at least two per cent per annum, and another that the tax to be levied for the erection of public buildings and other permanent improvements shall not exceed twenty-five cents of the $100 in any one year, has been considered by the United States Circuit Court of Appeals for the fifth circuit in an action against it upon bonds issued for public improvements. The court held that the power to create debts for this purpose was limited to a sum, upon which the interest, together with two per cent for the sinking fund would not exceed the revenue derived from a tax of twenty-five cents on the $100. After this city had issued bonds to such an amount that the interest and sinking fund absorbed the whole of the tax of twenty-five cents upon the $100, there was issued another series, and it was provided that the interest and sinking fund for this second series should be appropriated out of the general revenue of the city. The first issue of bonds, to the full amount authorized by the Constitution of the state, the court held, exhausted the power of the city to contract debts of this kind, and the additional series of bonds was held to be void, without regard to the authority of the city to apply its general revenue to the payment of interest and sinking fund of a bonded debt.[1]

braska, this may be done, provided it can be done without the destruction of rights recognized by the law as vested. In the present case the statute in question does not impose upon the [defendant city], by an arbitrary act, a burden without consent and consideration. On the contrary, upon the supposition that the bonds issued, as to the excess over fifteen thousand dollars, were void, because unauthorized, the city * * * received the money of the plaintiff in error, and applied it to the purpose intended, of building a school house on property, the title to which is confirmed to it by the very statute now claimed to be unconstitutional, and an obligation to restore the value thus received, kept and used, immediately arose. This obligation, according to general principles of law accepted in Nebraska, was capable of judicial enforcement. Clark *v.* Saline County, 9 Neb. 516; Louisiana *v.* Wood, 102 U. S. 294; New Orleans *v.* Clark, 95 U. S. 644; Hitchcock *v.* Galveston, 96 U. S. 341; Parkersburg *v.* Brown, 106 U. S. 487; Chapman *v.* Douglas, 107 U. S. 348."

[1] Millsaps *v.* City of Terrell, (1894) 60 Fed. Rep. 193.

§ 416. Effect of an order by resolution of council of a city for an election to authorize the issue of bonds.— A city of Kansas having issued its bonds upon which this action was founded under the general law of that state declaring that cities may "borrow money and issue bonds therefor" whenever "the city council shall be instructed so to do" by vote of the inhabitants the United States Circuit Court of Appeals for the eighth circuit held it to be no objection to the validity of the bonds that the council submitted the matter to the electors by means of a resolution, rather than an ordinance, there being nothing in the statutes expressly requiring an ordinance in such case.[1]

[1] City of Alma *v.* Guaranty Savings Bank, (1894) 60 Fed. Rep. 203. THAYER, D. J., speaking for the court, said, *arguendo:* "The law is well settled that a municipal corporation may declare its will as to matters within the scope of its corporate powers, either by a resolution or an ordinance, unless its charter requires it to act by ordinance; and generally it is of little significance whether a legislative measure is couched in the language of an ordinance or of a resolution, where it is enacted with the same formalities which usually attend the adoption of ordinances. If the action taken by a municipality amounts to prescribing a permanent rule of conduct, which is to be thereafter observed by the inhabitants of the municipality, or by its officers in the transaction of the corporate business, then, no doubt, the rule prescribed may be more properly expressed in the form of an ordinance; but it is eminently proper to act by resolution if the action taken is merely declaratory of the will of the corporation in a given matter, and is in the nature of a ministerial act. Beach Pub. Corp. § 484, and cases there cited; City of Lincoln *v.* Sun Vapor Street-Light Co., 59 Fed. Rep. 756. In the present case the resolutions in question appear to have been passed and entered at large upon the journal of the council, in the same manner that the council record also discloses that the vote was taken by yeas and nays, and that the resolution of March 18, 1889, directing an election to be held was published in substantial compliance with the provisions of the charter touching the publication of ordinances, and that after the council had been instructed by the inhabitants of the city to issue the bonds, at an election held for that purpose, the council did not publish its final resolution to issue the bonds, which had been passed in obedience to the popular mandate. It is also noteworthy that all of the proceedings taken to secure the issue of the bonds were conducted with the greatest publicity and apparent fairness. It is not charged that the resolutions were rushed through the council secretly, or with indecent haste, or that any one has been defrauded, or that the city did not receive full value for its bonds. Moreover, it is apparent, from an inspection of the first resolution, that, before the council took any action, the project of issuing the bonds had been discussed at a public meeting of the inhabitants of the city, and that the council had been requested to order an election." The court distinguished National Bank of Commerce *v.* Town of Granada, 54 Fed. Rep. 100; s. c., 4 C. C. A. 212; 10 U. S. App. 692.

§ 417. Bonds valid when issued as a part of the general indebtedness of the city.— In an action by citizens to restrain the issuing by a Minnesota city of certain "water and light bonds" it was contended by those bringing the action that it was the purpose of the legislature, in its amendment to the charter of the city, manifested by the wording of the law, to make the water and light bonds a special indebtedness, not enforceable against the city as were other bonds, but solely and exclusively by resort to the water and light franchises, structures and appliances. The Supreme Court of that state, however, affirmed the order of the court below sustaining a demurrer to the complaint, holding that under the amendment such bonds might be issued by the authorities of the city, the requisite preliminaries having been observed, as a part of the general indebtedness of the city, notwithstanding such bonded indebtedness already exceeded five per cent of the assessed valuation of the taxable property in the city, according to their then last assessment.[1]

[1] Woodbridge *v.* City of Duluth, (Minn. 1894) 59 N. W. Rep. 296. The court said: "It seems to be claimed that, because these bonds were made a special and exclusive lien upon the water and light plant or plants, it inevitably follows, without regard to other language found in the law, that they cannot be a part of the general indebtedness of the city, or, if they are, that they fall within the inhibitory clause of the charter. It would be a forced and unnatural construction of the enactment, probably operating to wholly defeat its purpose, to hold that the holders of the bonds could only look to the franchises, structures and appliances for payment. We are not inclined to presume that the legislature simply intended to confer upon the city the worthless privilege of putting bonds on the market, in the hope of their being purchased by capitalists who would be willing to advance money, that the city, without incurring any liability itself, might experiment in furnishing water and light to its citizens. Not only this, but if these bonds were not to be considered as a part of the general indebtedness of the city all reference to the five per cent clause was superfluous and unnecessary. There can be no doubt but that, while these bonds, undoubtedly for better security, are made a special and exclusive lien upon the plants, they were a part of the bonded indebtedness of the city as much as any other bonds. This leads up to the important inquiry already stated, and we are of the opinion that there is no ambiguity or doubt about the legislative intent and purpose, as expressed in the amendment. It will be noticed, and we have already referred to this, that by the first paragraph of the amendment to section 9 the council was authorized to make temporary loans, issuing coupon notes therefor, and, that there might be no question as to these notes, it was expressly provided that the indebtedness incurred in this way should be taken and held as part of the total indebtedness referred to in a preceding and prohibitory clause of the section. Then comes that part of the amendment which covers and authorizes the issuance of the bonds in question, and again did the legislature express itself in plain language, by declaring that the bonds so issued should not be deemed a part of the general indebtedness already referred to as not to exceed five per cent of the assessed valuation. Putting the language in a different form, it is that in estimating the bonded indebtedness of the city, for the purpose of ascertaining whether the limit had been reached, the water and light bonds should not be taken into consideration. No other effect can be given the language, and if it does not mean this it means nothing at all. The entire structure of the amendment indicates, unmistakably, that it was well appreciated by the legislature that water and light bonds which would serve the purposes of the city, and enable it to buy or build the necessary experiment, would have to be issued in a large amount far exceeding that already authorized. The office of the amendatory legislation was to empower the city to proceed without limitation or restriction as to the amount of the issuance of the bonds for the particularly specified object."

§ 418. Validity of bonds as affected by a restriction in the charter of a city.— A section of the charter of a city in Indiana provided for making "original loans" on the part of the city with this limitation: "Such loans may be made only for the purpose of procuring money to be used in the legitimate exercise of the corporate powers of such city and for the payment of legitimate corporate debts." The validity of certain bonds which had been issued by the city as part of a series of bonds for which the city had received bids was in question in an action in the federal court for that district, brought by the bidders for their relief from the bid and a recovery of money they had deposited as an earnest of their good faith. These bonds were for an amount to cover the amount of certain bonds of the city previously issued in payment for a farm, and which had been paid out of the treasury of the city and extinguished, the intention of their issue being with the proceeds to replace that money. The court held that as original loans these bonds were void and beyond the power of the city to issue.[1]

[1] Coffin *v.* City of Indianapolis. (1894) 59 Fed. Rep. 221. BAKER, D. J., said: "This limitation [in the charter] evidently means that when the city proposes to borrow money the ordinance shall state the purpose of the loan, in order that it may appear that the money procured is to be used in the legitimate exercise of corporate powers, or for the payment of legitimate corporate debts. If the city may issue and sell its bonds to raise money without stating any lawful purpose for which the money is to be used, the bonds would be valid if the money was used for a legitimate corporate purpose, and invalid if the money was illegitimately used. Such a construction would place upon the purchaser of bonds the burden of seeing to the rightful application of the money if he would maintain their validity. The city, in the present case, has rightfully

recognized the necessity of stating the purpose of the issue and sale of the bonds. Is the purpose stated as to twenty-one thousand dollars of the bonds a legitimate one? As we have already said, these bonds were not to be issued and sold for the payment of a legitimate corporate debt, because there was no debt to be paid. The Sellers farm debt had been paid, and the bonds evidencing the same had been canceled and discharged. Thereafter the debt ceased to exist. Is the raising of money, the issue and sale of bonds for the purpose of putting back into the treasury a sum equal to what had been used in the payment of a debt of the city 'a legitimate exercise of the corporate powers of such city?' If the city may issue and sell its bonds to replace in the treasury the money paid out on account of the Sellers farm debt, it may issue and sell its bonds to replace in the treasury all the moneys ever paid out by it on account of its debts and liabilities. In my judgment the issuance and sale of bonds for such a purpose is not within the scope of its legitimate corporate powers. The city cannot issue or sell its original bonds except for the purpose of raising money to pay some legitimate debt or liability, or to meet some future liability or obligations incurred, or to be incurred, in the legitimate exercise of its corporate powers." In the same opinion, in another place, it was said: "It is the settled law of Indiana that a city organized under the laws of the state cannot issue and sell its bonds, to raise money by way of loan, unless expressly authorized so to do. City of Aurora *v.* West, 22 Ind. 88; State *v.* Hauser, 63 Ind. 155; Rushville Gas Co. *v.* City of Rushville, 121 Ind. 206; s. c., 23 N. E. Rep. 72. Such is also the settled doctrine of the Supreme Court of the United States. Brenham *v.* Bank, 144 U. S. 173; s. c., 12 Sup. Ct. Rep. 559. And in case of doubt touching the existence of the power on the part of a city to issue and sell its bonds to raise money by way of loan, such doubt must be resolved against the existence of the power."

CHAPTER XX.

TOWNSHIP BONDS.

§ 419. Effect of ordinance of town council not being published upon the validity of the bonds.
420. Bonds for purchase of gravel road under Indiana statute — statute held to be constitutional.
421. The duty and power of county authorities where the vote of the towns is favorable in such cases.
422. Effect upon bonds of a constitutional limitation upon the indebtedness to be incurred by towns.
§ 423. Town bonds for improvement of public park under resolution of the Connecticut legislature — when authorized and to what extent.
424. The effect of recitals in town bonds as to estoppel of the town to claim they were issued without authority.
425. What is required of a bona fide purchaser.

§ 419. Effect of ordinance not being published upon the validity of bonds.— A town of Colorado issued certain fifteen-year bonds to a contractor for building a reservoir for water purposes under circumstances which indicated fraudulent collusion between him and the town authorities. Some of these bonds passed in regular course of trade to a bank which brought an action upon coupons for interest thereon in the federal court for that district. The question decided was between the bank, a purchaser of the bonds for valuable consideration, before maturity, and in good faith, and the defendant corporation, the officers and agents of which permitted the bonds to be placed upon the market as commercial paper. The bonds as offered for sale were in due form and properly executed. They had been registered with the state auditor and recorded by the town treasurer, as certified on their face. It was recited in the bonds that they had been issued under the sanction of an ordinance providing therefor, for funding and paying the existing debts of the city of Grenada. The United States Circuit Court held that it was open to the town to defend in this action even against the *bona fide* holder and purchaser for value, notwithstanding the recital in the bonds; that there was no authority for the issue of the bonds, and they were

invalid obligations even in the hands of the holder suing upon them.[1] In the United States Circuit Court for the district, by the court, upon an agreed statement of facts upon the new trial which had been ordered, in the same case, the judgment was similar to that in the District Court.[2] This judgment was appealed from,

[1] National Bank of Commerce *v.* Town of Granada, (1890) 44 Fed. Rep. 262.

[2] National Bank of Commerce *v.* Town of Granada, (1891) 48 Fed. Rep. 278. PARKER, J., in rendering his judgment finding the bonds to be invalid, said: "It is my conclusion that under the laws of Colorado there must have been an ordinance of the town of Grenada to authorize the issuance of the bonds, the coupons of which are the basis of the suit in this case." He then quoted the general statute of the state as to ordinances of municipal corporations, and said: "By the terms of this section of the statute law of the state, when the same is given a reasonable construction, all by-laws of a general or permanent nature must be published as required by the above-named section. This ordinance of the town of Grenada passed by its council, purporting to authorize the issue of the bonds to which the coupons in suit were attached, is of a general or permanent nature, and all by-laws or ordinances of a general or permanent nature do not take effect or be in force until the expiration of five days after they have been published or posted. It appears from the agreed statement of facts in this case that there never was any publication of the ordinance in a newspaper, or in any manner or form whatever. The statute requiring the publication of the ordinance is mandatory, and the ordinance, without the requisite publication, is a nullity, and consequently of no force or validity. There is, then, no authority for the issue of the bonds to which the coupons in suit belong. The recital in the bond, that it was issued under an ordinance of the city of Grenada passed by the council of said city, will not make the bond valid in the hands of plaintiff as an innocent holder, if it, under the law, was bound to take notice of the legal authority of the town of Grenada to issue the bond. The legal authority of the officers of the town must be found in some ordinance authorizing them to act. The recitation on the face of the bond that it was issued under an ordinance referred the purchaser to the law requiring the publication of the ordinance. The ordinance conferred no legal authority upon the town officers to execute and issue the bonds until the expiration of five days after it had been published. The corporation of Grenada must have had legislative authority to issue the bonds issued by it. Although the plaintiff is a holder for value and before maturity, it must, at its peril, take notice of the existence and terms of the law by which it is claimed the power to issue such bonds is conferred. The holder of a municipal bond is chargeable with notice of the statutory provisions under which it was issued." The court cited in support of the last point Bank *v.* City of St. Joseph, 31 Fed. Rep. 216; Anthony *v.* Jasper County, 101 U. S. 693; Ogden *v.* Daviess County, 102 U. S. 634; Bank *v.* Porter Township, 110 U. S. 608; s. c., 4 Sup. Ct. Rep. 254; McClure *v.* Township of Oxford, 94 U. S. 429. This last case was regarded by the court as especially relevant to the present one.

and the United States Circuit Court of Appeals affirmed the judgments already rendered in the courts below.[1]

§ 420. Bonds for purchase of gravel road under Indiana statute — statute held to be constitutional.—The statute of Indiana which provides for the purchase of gravel roads upon an

[1] National Bank of Commerce *v.* Town of Granada, (1893) 54 Fed. Rep. 100. As to the questions involved and the views of this court upon them, CALDWELL, Circuit Judge, said: "We think the principal and vital question in this case is whether the powers conferred on the board of trustees may be exercised without an ordinance containing the usual and necessary provisions to guide, control and bind the town and its officers and the public in the execution of the funding scheme, and to protect all persons in their rights acquired thereunder. We entertain no doubt but that the appropriate mode for the town to proceed under the act in question is by ordinance of its board of trustees. The proceeding involves the appointment and holding of an election, and the conversion of a non-negotiable floating debt into the form of negotiable bonds drawing a high rate of interest payable semi-annually, and which must run five, and may run fifteen, years. A measure requiring an expression of opinion from the voters of the town at the ballot box and involving such large values and of so much interest to the taxpayers of the town and the holders of its securities through so many years, ought not to be carried into effect except by the most solemn and deliberate mode of proceeding known to the law for giving expression to the corporate will. That mode is by ordinance. * * * The statutes of the state [of Colorado] which authorize the issue of refunding bonds, * * * the creation of new indebtedness, * * * and the appropriation of aid to public libraries, * * * require in terms that the same shall be done by ordinances. We think the board of trustees of the town had a correct conception of the proper mode of proceeding when they passed the ordinance in question." The statute prescribing the regulations as to ordinances is then referred to, and then the court resumed: "It is admitted that the ordinance in question was not 'recorded in the book kept for that purpose,' and was not 'authenticated by the signature of the presiding officer of the * * * board of trustees and the clerk,' and 'was never published in any paper or in any form or manner whatever.' It is obvious to our minds that the ordinance in this case was of a 'general or permanent nature' [the words of the statute], and as such could 'not take effect and be in force until the expiration of five days' after its publication. It provided for an election, and, therefore, concerned every legal voter of the town. It affected every taxpayer, whether a voter or not. It affected the creditors of the town, present and future. It involved the making and execution of contracts, and various other matters relating to funding the floating indebtedness of the town. If such an ordinance is not of a 'general or permanent nature' it would be extremely difficult to suggest one that is. The provision of the act, that such ordinances shall not take effect or be in force until they are published in the mode provided by the act, is mandatory. The ordinance, never having been pub-

election of the voters of the township or townships through which they pass, ordered upon petition of a certain number of the freeholders thereof, and the finding of certain facts as to the number of voters, etc., by the board of county commissioners, the purchase money to be provided by the issuing of county bonds of a certain kind, which are to be paid by a levy of taxes annually upon the property of the citizens of such townships, was attacked as unconstitutional in an action by taxpayers of one

lished, never went into effect. Not being in force, it conferred no authority on the board of trustees, or any officer of the town, to do any act under it; and no one could acquire any right based on it, or on any act of the officers of the town assuming to act under it. It had no more legal effect than if it had never been passed by the board of trustees. 1 Dill. Mun. Corp. §§ 331–334, and notes. But the learned counsel for the plaintiff in error contends that the recital in the bonds, that they 'are issued under an ordinance' of the town relieves the plaintiff from the burden of showing that the ordinance was published, and estops the defendant from showing that it was not. It has never yet been held that a false recital in a bond can make that a law which never was a law. When an ordinance has been duly enacted, and has taken effect, authorizing the officers of a town to issue its negotiable bonds upon certain precedent requirements or conditions, such as a petition of a given number of taxpayers, or a majority vote or other like conditions, and the officers issuing the bonds are the appointed tribunal to decide whether there has been a compliance with such precedent conditions, and the bonds issued recite that they are issued in pursuance of such ordinance, it is probably true that such recital, in favor of *bona fide* purchasers for value, would import a full compliance with the requirements of the ordinance, and preclude inquiry as to whether the precedent conditions were performed before the bonds were issued. But that doctrine has no application to this case. Here there was no ordinance in force under which the board of trustees, or any officer of the town, could perform any act. The authority to issue the bonds never attached, on any terms or conditions. The action of the mayor and clerk was not simply irregular, but was without the sanction of any law. The point was never reached at which they could lawfully do any act under the supposed ordinance. It is a case of a total want of authority to do the act upon any conditions, and not a case where the authority to do the act existed, but the conditions precedent to the exercise of the authority were not observed. The statute which provides that ordinances shall not take effect until they are published is a public statute, of which all persons are bound to take notice. The statute makes the recording of an ordinance in the ordinance book *prima facie* evidence that it has been published according to law. But this ordinance was not recorded, nor authenticated as an ordinance by the signatures of the mayor and clerk, as required by law. Moreover, it is not shown that the mayor and clerk, or either of them, had any duty or function to perform in relation to publishing ordinances, or determining when they had been published according to law. The determination of this fact, when it becomes material, and is contested, and the ordinance has not been recorded, is, under the statute, a matter for judicial inquiry. The statute itself provides that it shall be a sufficient defense to any suit or prosecution for a fine, penalty or forfeiture to show that the ordinance imposing it was not published as required by the statute, and it is obvious that the same defense must prevail against any civil right grounded upon an ordinance which was never published, no matter by or against whom such right is asserted. The plaintiff was bound to know, independently of the recital in the bond, that there was such an ordinance in existence. This fact once established, it might well assume that the recital was sufficient evidence that the conditions prescribed by the ordinance for issuing the bonds had been complied with. It was as much the right and duty of the plaintiff to determine this question as it was the clerk and themayor, and the determination of either, in any form, would not bind or conclude the town. It is only when officers are invested by law with the authority to determine or adjudicate upon the fact that their recital operates as an estoppel. If the recital in this case had stated, in terms, that the ordinance had been duly published, it could not have estopped the town, because neither the mayor nor the clerk, nor both together, are invested with the authority to determine that question, and anything they might say or certify to on the subject, save as witnesses in court, would not be evidence anywhere, or bind any one. Dixon Co. *v.* Field, 111 U. S. 83, 94; s. c., 4 Sup. Ct. Rep. 315; Sutliff *v.* Lake County Commis., (1892) 13 Sup. Ct. Rep. 318. * * * The law does not refer the public to these officers, or to either of them, for information as to the publication of town ordinances; and their statements upon that subject have no more significance or binding force than those of any other citizen of the town."

of three townships upon the property of which such a levy of taxes was made, to restrain the collection of such tax. The contention on behalf of the taxpayers was that the statute was void as violative of these constitutional provisions, to wit: "The general assembly shall not pass local or special laws in any of the following enumerated cases, that is to say: For the assessment and collection of taxes for state, county, township or road purposes;" also, the following: "The general assembly shall provide, by law, for a uniform and equal rate of assessment and taxation, and shall prescribe such regulations as shall secure a just valuation for taxation of all property, both real and personal, excepting such only for municipal, educational, literary, scientific, religious or charitable purposes, as may be specially exempted by law. The Supreme Court of the state upheld the statute as constitutional.[1]

[1] Gilson *v.* Board of Commissioners of Rush County, (1891) 128 Ind. 65. *Arguendo*, the court said, upon the point made as to the first quoted section: "It is held that a statute which is of general and uniform operation throughout the state, and operates alike upon all persons, under the same circumstances, is not subject to the

§ 421. The duty and power of county authorities where the vote of the towns is favorable in such cases.— The court, in construing the statute of Indiana as to purchase of a gravel road running through several townships, held that when the election is held in a number of townships, it having been ordered in response to the petition signed by voters of all the townships, and the majority of the voters is in favor of making the purchase of the gravel road running through the townships, with a view to its becoming a free gravel road, it becomes the duty of the county commissioners of the county in which the townships are situated to make the purchase. And they then are authorized to issue bonds for the purpose and levy a tax upon the citizens of the townships interested for their payment.[1] The Supreme Court of the United States has held that the requirement of a charter, that the bonds issued by a municipal cor-

objection that it is special or local legislation. State ex rel. *v.* Reitz, 62 Ind. 159; McLaughlin *v.* Citizens', etc., Assn., 62 Ind. 264; Heanley *v.* State, 74 Ind. 99; Elder *v.* State, 96 Ind. 162. The statute we are now considering is of uniform operation throughout the state of Indiana, and applies alike to all persons coming within its operation, and is not in conflict with the provisions of [the first section quoted]." Whether it was in conflict with the last section quoted, the court considered a more serious question and fully discussed it, as follows: "This provision of our Constitution received a construction in the case of Bright *v.* McCullough, 27 Ind. 223. It was said in that case: 'The section does not require that the rate of assessment shall be uniform and equal for all purposes throughout the state, and we think its meaning clearly is that the rate of assessment and taxation must be uniform and equal throughout the locality in which the tax is levied.' So, again, it received a construction in the case of LaFayette, etc., R. R. Co. *v.* Geiger, 34 Ind. 185. That was a suit to enjoin the levy and collection of a tax in aid of the construction of a railroad. It was contended that inasmuch as the railroad ran through the counties of Madison, Tipton, Clinton, Tippecanoe and Benton in this state, it was necessary that each and all of the counties must vote for an appropriation and assess the same amount of tax in each county to make it uniform and equal. In answer to this contention, the court said: 'If the tax assessed is equal and uniform in the county where assessed, it will be in strict accordance with the requirements of the Constitution.' See, also, John *v.* Cincinnati, etc., R. R. Co., 35 Ind. 539. It is not unusual for the legislatures of the several states in the Union, in the exercise of the general power of taxation, as well as in the power of local assessments, to create a special taxing district without regard to municipal or political subdivisions of the states, and to levy a tax on all property within such district by a uniform rule, according to its value, for the purpose of aiding in the construction of public improvements. Our laws providing for street improvements, for the construction of free gravel roads, for the construction of ditches and drains, and for aid in the construction of railroads, are examples of this kind of legislation. True, in most cases, such improvements are paid for by local assessments against real property, which, in theory, is benefited to an amount equal to the assessment. But it is by no means universally true that such improvements are paid for by assessments against real estate supposed to be benefited; but, on the contrary, they are often paid for by the assessment of a tax on all property found within the taxing district. The doctrine announced in Bright *v.* McCullough, *supra*, that the requirements of [the last section of the Constitution referred to] are fulfilled when the rate of assessment and taxation is uniform and equal throughout the taxing locality, has often been affirmed by this court. Palmer *v.* Stumph, 29 Ind. 329; Anderson *v.* Kerns Draining Co., 14 Ind. 199; Goodrich *v.* Winchester, etc., T. P. Co., 26 Ind. 119. In the case of Bowles *v.* State, 37 Ohio St. 35, the question now under consideration was discussed at some length by the Ohio court. The case involved the constitutionality of a statute passed by the general assembly of that state authorizing the assessment of all property, both real and personal, within a given district, to pay for the construction of a free turnpike road. It was contended that the legislature had no power to create a taxing district without regard to the boundaries of the political or municipal subdivisions of the state, and in answer to this objection the court said: 'That the power is not expressly inhibited is clear, and we are persuaded there is no implication against it from the fact that it has always been exercised without challenge in divers ways for the purpose of promoting local advantages, not only in the exercise of the power of local assessments, where the burden of local improvements has been placed upon property specially benefited and in proportion to the benefit, but by general taxation upon local districts other than municipal or political subdivisions. Notably, special taxing districts have been created for the purpose of supporting and maintaining schools and highways by the subdivisions of townships; and we can see no difference in principle between such legislation and the statute under consideration.' These several adjudications seem to be in exact accord with the elementary books upon the same subject. Cooley Taxation (ed. 1876), p. 113; see, also, pp. 110, 111, 112; Elliott Roads & Streets, 392, 393." See, also, to the same effect, People *v.* Central Pacific R. R. Co., 43 Cal. 398; County Judge *v.* Shelby R. R. Co., 5 Bush, 225; Challiss *v.* Parker, 11 Kans. 394; People ex rel. *v.* Draper, 15 N. Y. 532; Buffalo, etc., R. R. Co. *v.* Board, etc., 48 N. Y. 93; Litchfield *v.* McComber, 42 Barb. 288; Sangamon, etc., R. R. Co. *v.* County of Morgan, 14 Ill. 163; Bakewell *v.* Police Jury, 20 La. Ann. 334; Inhabitants of Norwich *v.* County Commissioners, 13 Pick. 60; Inhabitants of Brighton *v.* Wilkinson, 2 Allen, 27; Salem Turnpike *v.* County of Essex, 100 Mass. 282; Missouri River, etc., R. R. Co. *v.* Morris, 7 Kans. 210.

[1] Gilson *v.* Board of Comrs. of Rush County, (1891) 128 Ind. 65. The court said: "In our opinion, it was the intention of the legislature, in passing the act under consideration, that where two or more townships joined in a petition to the board of county commissioners to purchase a particular toll-road, all the townships joining in such petition should be taxed to pay for the same, in the event a majority of the votes cast was in favor of such purchase, though there may have been a failure to obtain a majority in one of the townships. Where the townships

poration shall specify for what purpose they are issued, was not so far satisfied by a bond which purported on its face to be issued by virtue of an ordinance, the date of which was given, but not its title or contents, as to cut off defenses which might otherwise be made.[1]

have joined in such petition, and the vote is in favor of the purchase, the townships thus voting may well be said to have voted in favor of such purchase. The result of holding otherwise might be that two townships would purchase the two ends of a toll-road while a majority of one vote in a township between the two would defeat the purchase of the center, and thus destroy the value of the road as a free thoroughfare. We do not think it was the intention of the legislature to permit such a result. The contention that the elections, in all cases under this law, are to be several, is destroyed by the provision made for a joint petition. Had it been the intention of the legislature that the purchase should depend on the result of the election in each township, it is reasonable to assume that the legislature would have provided for several elections, and would have made no provision for joint petitions and a joint election."

[1] Barnett *v.* Denison, (1892) 145 U. S. 135. The state of the law in such a case was declared by Mr. Justice BROWN, speaking for the court, to be as follows: "It is the settled doctrine of this court that municipal corporations are merely agents of the state government for local purposes, and possess only such powers as are expressly given, or implied, because essential to carry into effect such as are expressly granted (1 Dill. Mun. Corp. § 89; Ottawa *v.* Carey, 108 U. S. 110); that the bonds of such corporations are void unless there be express or implied authority to issue them (Wells *v.* Supervisors, 102 U. S. 625; Claiborne County *v.* Brooks, 111 U. S. 400; Concord *v.* Robinson, 121 U. S. 165; Kelley *v.* Milan, 127 U. S. 139); that the provisions of the statute authorizing them must be strictly pursued, and that the purchaser or holder of such bonds is chargeable with notice of the requirements of the law under which they are issued. Ogden *v.* County of Daviess, 102 U. S. 634; Marsh *v.* Fulton County, 10 Wall. 676; South Ottawa *v.* Perkins, 94 U. S. 260; Northern Bank *v.* Porter Township, 110 U.S. 608; Hayes *v.* Holly Springs, 114 U. S. 120; Merchants' Bank *v.* Bergen County, 115 U. S. 384; Harshman *v.* Knox County, 122 U. S. 306; Coler *v.* Cleburne, 131 U. S. 162; Lake County *v.* Graham, 130 U. S. 674. It is certainly a very reasonable requirement that the bonds issued shall express upon their face the purpose for which they were issued. In any event, it was a requirement of which the purchaser was bound to take notice, and if it appeared upon their face that they were issued for an illegal purpose they would be void. If they were issued without any purpose appearing at all upon their face, the purchaser took the risk of their being issued for an illegal purpose, and if that proved to be the case they are as void in his hands as if he had received them with express notice of their illegality. Ordinarily the recital of the fact that the bonds were issued in pursuance of a certain ordinance, would be notice that they were issued for a purpose specified in such ordinance (Hackett *v.* Ottawa, 99 U. S. 86), and the city would be estopped to show the fact to be otherwise. Ottawa *v.* National Bank, 105 U. S. 342. But where the statute requires such purpose to be stated upon the face of the bonds, it is no answer to say that the ordinance authorized them for a legal purpose, if in fact they were issued without consideration and for a different purpose. In this case the bonds were not only issued for a purpose not named in the ordinance, viz., in aid of the Texas and Atlantic Refrigerator Car Company, which had agreed to erect at Denison slaughter houses, tanks, machinery and other material of the value of fifteen thousand dollars, but upon a consideration which had wholly failed, the company having failed to comply with the terms of the contract; and the bonds, so far as they were known to exist, were canceled." The court then commented upon certain cases to which their attention had been called in these words: "In Kansas *v.* School District No. 3, 34 Kans. 237, relied upon by the plaintiff, the state sued a school district upon certain school-district bonds and their coupons. Upon the trial the defendant objected to the introduction of any evidence upon the petition, upon the ground that the same did not state facts sufficient to constitute a cause of action, and the court sustained the objection and dismissed the action. One of the objections urged by the defendant against the petition was that the bonds did not state, as required by statute, the purpose for which they were issued. The court held that the bonds were not void for that reason, because under the allegations of the petition they must be considered as issued in good faith; 'that the school district received ample consideration for them, and that the state of Kansas is an innocent and *bona fide* purchaser of them, for nothing appears to the contrary in the petition, and all the allegations of the petition would tend to indicate this.' This ruling, however, is not inconsistent with the idea that if they had been issued for an illegal purpose the purchaser would have been chargeable with notice of such illegality by reason of the omission to state on the face of the bonds the purpose for which they were issued. In Young *v.* Camden County, 19 Mo. 309, the act required that county warrants should be written or printed in Roman letters without ornament, in order to prevent the issuing of paper by County Courts which could be used as a circulating medium. This was held to be merely directory; but this case, though cited by the plaintiff here, is not in point. The court held expressly that all the words prescribed by the statute were in the warrants, and that the introduction of other words did not vitiate them."

§ 422. Effect upon bonds of a constitutional restriction upon the indebtedness to be incurred by towns.— The board of trustees of a town in Indiana adopted an ordinance directing that bonds of the town be issued to procure funds with which to rebuild a school house which had been destroyed by fire. The Supreme Court of that state held that such proposed bonds were within the constitutional provision of that state restricting the power of public corporations to incur indebtedness, which is in these words: "No political or municipal corporation in this state shall ever become indebted, in any manner or for any purpose, to an amount in the aggregate exceeding two per centum on the

value of the taxable property within such corporation, to be ascertained by the last assessment for state and county taxes previous to the incurring of such indebtedness; and all bonds or obligations in excess of such amount given by such corporation shall be void." Also, that because there was a provision or promise to levy taxes to pay the bonds did not prevent the application of the constitutional provision to the bonds.[1] The court further sustained the right of a taxpayer to maintain an action for injunction to prevent the issue of these town bonds as without authority.[2]

§ 423. Town bonds for improvement of public park under resolution of the Connecticut legislature — when authorized and to what extent.— A Connecticut town was empowered by a resolution of the general assembly to issue its bonds to an amount not exceeding $200,000, to be used exclusively for the extension and improvement of the public park system of the town; the act to take effect when accepted at a special town meeting to be called by the selectmen; and the meeting to have power to take action with respect to the issuing of the bonds, and their form and terms. A later section provided that the park commission created by the act should not make any expenditure, or contract for any, exceeding the amount which shall have been previously appropriated by the

[1] Town of Winamac *v.* Huddleston, 1892) 132 Ind. 217.

[2] Ibid. It was said by the court: "There can be no doubt that if the bonds are executed as proposed, and are of any validity, they will create a debt against the public corporation. In this particular, as in others, this case is radically different from that of The City of Valparaiso *v.* Gardner, 97 Ind. 1. The debt created by a bond executed by a public corporation is not an obligation payable out of specific funds, but is a contract to pay money generally, and, hence, this case is not within the doctrine of such cases as Quill *v.* City of Indianapolis, 124 Ind. 292; Strieb *v.* Cox, 111 Ind. 299; Board, etc., *v.* Hill, 115 Ind. 316. A valid bond binds the corporation directly and unconditionally unless it is otherwise expressly stipulated in the instrument as provided by law. If the bonds to be issued are not valid because of want of authority, then, no matter what may be the cause of the invalidity, they should not be issued, so that if counsel are right in saying that the town has no authority to issue the bonds the judgment below must be sustained." As to the remedy in such a case it was said: "There is no other remedy of equal power and efficiency, and the case here comes within the rule declared in such cases as Watson *v.* Sutherland, 5 Wall. 74; Denny *v.* Denny, 113 Ind. 22; Bishop *v.* Moorman, 98 Ind. 1, and other cases there cited."

town for its use. At a meeting warned and held for the purpose the town accepted the resolution of the general assembly and voted "that the selectmen and treasurer are hereby directed to prepare suitable bonds as authorized by said act, not exceeding two hundred thousand dollars, of the tenor, character and terms hereinafter provided, and are authorized to dispose of them in such amounts and at such times as shall be required by the park commission, to provide the sums made necessary by said commission in its proceedings under said act." Parties from whom the park commissioners had purchased lands for a public park, with the proper officials of the town, agreed upon a submission to the Supreme Court of the question of the right and duty of the officials of the town to issue bonds in payment of the land so purchased. The court held that it was the duty of the selectmen and treasurer of the town to issue bonds within the limit prescribed, to an amount sufficient to pay for the lands.[1]

[1] Woodward *v.* Reynolds, (1890) 58 Conn. 486. *Arguendo*, it was said by the court: "At the meeting held in pursuance of [the] warning [above referred to], in connection with a vote prescribing what the tenor, character and terms of the bonds should be, the following vote was passed: '*Voted*, that the selectmen and town treasurer be and are hereby directed to prepare and procure suitable engrossed bonds, as authorized by said act, not exceeding two hundred thousand dollars in total amount, bearing interest at a rate not exceeding three and a half per cent per annum, and of the tenor, character and terms hereinafter provided; and are further authorized to dispose of said bonds from time to time at not less than par and accrued interest, in such amounts and at such times as shall be required by the park commission to be constituted under the provisions of said act, in order to provide the sums made necessary by said commission in its proceedings under said act.' Whatever opinion may be held as to the effect of these votes, no question, so far as we know, has been or indeed can be raised as to the power conferred by the resolution, and the warning of the meeting contained a sufficient notice that the town would or might take the action indicated by the votes. The only question then is, whether these votes constitute an appropriation by the town within the meaning of section four of the resolution." Referring to definitions of "to appropriate" it is said: "In the case at bar, after the bonds are issued by the town, the resolution itself provides that they shall be used solely for the extension and improvement of the public park system in the manner provided in the resolution. This is in itself an appropriation of the bonds by legislative provision, but it is claimed that it is not the appropriation referred to in the fourth section of the resolution, and obviously it is not. Did the town then by the votes aforesaid make an appropriation within the meaning of section four? We think it did. Its agents, appointed for such purpose by the resolution itself, are directed and empowered by the town to procure

§ 424. The effect of recitals in town bonds as to estoppel of the town to claim they were issued without authority.— The recitals of those invested with the ministerial duty of issuing municipal bonds in such bonds, where there is an entire absence of power to issue them, will afford no protection to even *bona fide* holders for value, and the holders are bound to take notice of the want of authority to issue them.[1] The recitals in certain school bonds were that they were issued by the board of directors by authority of an election of the voters of the district in conformity with the provisions of the statute authorizing them. The United States Supreme Court held that it was not to be implied from these recitals that the bonds had been issued in conformity with the constitutional provision in regard to limit of indebtedness of such a corporation, and that, as to this defense, the holders took the bonds at their peril. In order to estop the municipality, in the name of which they have been issued, from showing that bonds were issued in violation of, or without authority of, law, the recitals on the face of the bonds should be clear and unambiguous.[2]

the bonds provided for in the resolution; the number and amount to be so procured and issued are specified; ample provision is made for their proper execution, authentication, and custody until they shall be issued and used; it is further provided that they shall be disposed of for the purposes of providing a fund for the use of the commission under the resolution; and, finally, these agents are fully empowered and directed to issue them from time to time as required for the needs of the commission. In this action of the town it is difficult to see what element or essential of a complete appropriation is wanting. There remained nothing more for the town to do. If the town had been called together prior to the purchase here in question, and after the passage of the votes, to make an appropriation with reference to the purchase of the land, it could only have instructed its agents to do what it had already empowered and directed them to do. The resolution itself provides in section six as follows: 'The bonds authorized in the first section of this act shall be prepared by the selectmen and town treasurer of New Haven, and shall be issued by them from time to time in such amounts as the park commission shall require. Such bonds shall in no case be sold or disposed of for less than par, and the avails of such as shall be issued shall be kept by the town treasurer as a special fund subject to the orders of the park commission, and shall be paid by him only on such orders.' Construing the votes in the light of this language of the resolution, we think they clearly make an appropriation, even within the meaning of section four of the resolution. To construe them otherwise would, we think, defeat the manifest intent and purpose of the town in passing them."

[1] Lippincott *v.* Town of Pana, 92 Ill. 24; Williams *v.* Town of Roberts, 88 Ill. 11.

[2] School District *v.* Stone, 106 U. S. 183. An illustration of bonds void by

§ 425. What is required of a bona fide purchaser of bonds. — The United States Supreme Court having ordered this case remanded upon its reversal of the judgment of the Circuit Court, upon the trial the Circuit Court made special findings sustaining the answers of the township and rendered judgment in its favor. The plaintiff's contention before the United States Circuit Court of Appeals for the sixth circuit was that, as it was a *bona fide* purchaser for value of the bonds in suit, it was not charged with notice of anything but the text of the statute itself, and was not bound to inquire into the motives or intent of the legislature, as inferred from other acts passed at the same time, and from facts extraneous to the act under which the bonds were issued, the existence or significance of which it could not know; that, on the face of the act, it raised exactly the same question of constitutionality which was considered in the case of Walker *v.* Cincinnati, 21 Ohio St. 14. The counsel for the plaintiff further attempted to explain away the decision of the Supreme Court of the United States by insisting that the hearing before that court [when it declared the act under which the bonds were issued to be unconstitutional] was on the averments of the answer with respect to the surrounding circumstances under which the bonds had been issued, and that no question was then before the court as to the right to use such evidence, in attacking the constitutionality of the law, against a *bona fide* purchaser of the bonds for value, without notice. To this the appellate court said: "We do not find it necessary to consider the objection that *bona fide* holders of bonds are not charged with a knowledge of surrounding circumstances which render the Enabling Act invalid, because while the Supreme Court did refer to such circumstances in the discussion of the act's validity, still the court held that, even if all the surrounding circumstances were ignored, the act was invalid, and was plainly distinguishable from the Walker case."[1]

reason of the notices of election in favor of them not being sufficient, and that no person could be an innocent purchaser of them. George *v.* Oxford Township, 16 Kans. 72. As to the unconstitutionality of an act of the Kansas legislature "authorizing townships to issue bonds for relief purposes," see State ex rel. *v.* Osawkee Township, 14 Kans. 418.

[1] Ætna Life Ins. Co. *v.* Pleasant Township, (1894) 62 Fed. Rep. 718, following Pleasant Township *v.* Ætna Life Ins. Co., 138 U. S. 67; s. c., 11 Sup. Ct. Rep. 215, holding the Enabling Act to be unconstitutional.

CHAPTER XXI.

SCHOOL DISTRICT BONDS.

§ 426. School district bonds generally.
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§ 426. School district bonds generally.— Municipal corporations, unless authorized by their charters, have no power to make and place in the market commercial paper, and persons dealing in municipal bonds issued by the officers of a school district must see that the power to issue them exists. There is no presumption that such paper has been issued within the scope of their power, as is the case with corporations created for business purposes.[1] Common councils of cities and boards of trustees of towns in Indiana are authorized to issue bonds of their municipalities, without petition of citizen owners of property therein, for the purpose of construction of school buildings.[2] Bonds issued and sold by a board of education for the purpose of building a dormitory and boarding house have been held to be illegal where such buildings were in no sense necessary for a public free school, and the power denied to levy taxes to pay interest on such bonds.[3] Bonds issued by a school district in excess of the constitutional limit of the indebtedness of such a corporation have been held to be void even without regard to the good faith with which they were purchased and the want of notice of their invalidity.[1] School bonds, under the laws of Ohio, reciting upon their face conformity with the statute in the matter of their execution, have been held to be promissory notes negotiable by the law merchant.[2] Their qualities and incidents as commercial securities are not taken away by recitals on the face of the bonds that they were issued conformably to statute; neither is their negotiable character destroyed by the fact that option was reserved to the county to pay at any time before maturity.[3] The purchaser of a municipal bond issued without authority, or in violation of law, is not an innocent purchaser. The law makes it his duty to look to the authority under which the officers of the municipality acted. He may rely upon the recitals in the bonds for some purposes, but for proof of the authority of the officers of the corporation, such recitals are not binding on the principal where there is a want of authority.[4] If bonds purporting to be school bonds negotiable on their face be false and forged when delivered, the vendor of them, by the mere act of sale, will be held to impliedly warrant the genuineness of the bonds and liable to the vendee or his assignee for what the latter paid for them, with interest.[5] But a return or an offer to return the bonds is necessary to entitle the vendee to maintain a suit against the vendor for the amount he may have paid for such bonds.[6]

[1] Hewitt *v.* Board of Education, 94 Ill. 528.

[2] Clark *v.* Town of Noblesville, 44 Ind. 83.

[3] Sherlock *v.* Winnetka, 68 Ill. 530.

[1] Mosher *v.* Independent School District, 44 Iowa, 122. In Sherlock *v.* Winnetka, 68 Ill. 530, it was held that although the bonds issued in the case by a board of education, under a law for a proper purpose, may have been valid in the hands of innocent holders for value, notwithstanding a perversion of the uses for which they were intended, yet if a bill had been filed showing an intended perversion, or that the buildings to be erected with the proceeds of the bonds would be perverted, the board would have been enjoined from issuing them.

[2] Ackley School District *v.* Hall, 113 U. S. 135.

[3] Ibid.

[4] Town of Pana *v.* Lippincott, 2 Bradw. (Ill.) 466. An illustration of the estoppel of a municipal corporation by the recitals in a bond issued by it. Bolton *v.* Board of Education, 1 Bradw. (Ill.) 193. As to recitals in bonds not estopping the municipality to set up the defense of violation of the constitutional limitation upon its indebtedness in their issue, see Bates *v.* Independent School District, 25 Fed. Rep. 192; Geneva National Bank *v.* Independent School District, 25 Fed. Rep. 629; Nesbit *v.* Independent School District, 25 Fed. Rep. 635.

[5] Smith *v.* McNair, 19 Kans. 330.

[6] Ibid. Under the statute of California providing that trustees of a

§ 427. Bonds executed by a de facto board of education.—Where a *de facto* board of education, exercising all the powers and functions of such a corporation legally organized, is recognized and its action acquiesced in by the state and the citizens, bonds issued by it, within the powers granted to a board legally organized, are binding in the hands of *bona fide* purchasers.[1]

§ 428. The power of a city in California to issue bonds for building school houses.—In a controversy between a taxpayer and a city in California holding a freeholder's charter the power of the city to issue certain bonds for the purpose of building school houses was denied. There had been enacted by the legislature of California an act authorizing the incurring of indebtedness for municipal improvements, and issuing bonds therefor by cities, towns and municipal corporations. One provision of this act was that "Any city, town or municipal corporation, incorporated under the laws of this state, may, as hereafter provided, incur an indebtedness to pay the cost of any municipal improvement, or for any purpose whatever requiring an expenditure greater than the amount allowed for such improvement by the annual tax levy." The next provision in the act prescribed

school district may submit to the electors thereof the questions whether bonds shall be issued for purchasing a school lot and for building school houses, the Supreme Court held that the question of buying a lot and building a school house may be submitted jointly with the question of issuance of bonds. People ex rel. Hart, Atty.-Gen., *v.* Caruthers School Dist., (Cal. 1894) 36 Pac. Rep. 396. As to the holding of elections in the state of Washington for issuance of school bonds by school districts, and what is required by law, see Luzader *v.* Sargeant, (1892) 4 Wash. St. 299.

[1] National Life Ins. Co. of Montpelier *v.* Board of Education of City of Huron, (1894) 62 Fed. Rep. 788. The court said: "It is the province of the state to question, by proper judicial proceedings, [the] incorporation [of the board of education]; not that of a defendant in a private suit when it has asserted its corporate existence and incurred liabilities to innocent parties on the faith of it. When a municipal body has assumed, under color of authority, and exercised for any considerable period of time, with the consent of the state, the power of a public corporation, of a kind recognized by the organic law, neither the corporation nor any private party can, in private litigation, question the legality of its existence." Ashley *v.* Board, 60 Fed. Rep. 55, 63; s. c., 8 C. C. A. 455; County of Ralls *v.* Douglas, 105 U. S. 728, 730; Coler *v.* School Tp., (N. D.) 55 N. W. Rep. 587; Clement *v.* Everest, 29 Mich. 19; Burt *v.* Railroad Co., 31 Minn. 472; s. c., 18 N. W. Rep. 285, 289; People *v.* Maynard, 15 Mich. 463; Fractional School Dist. No. 1 *v.* Joint Board of School Inspectors, 27 Mich. 3.

the steps to be taken, a vote by the citizens, etc. All of the requirements of the statute had in the case of these bonds been complied with. It was claimed that the city had no power to issue its bonds for the construction of school houses, for the reason that the management of its schools was vested in a board of education, and that any bonds to be issued for school purposes must be authorized by that body. The Supreme Court of the state sustained the validity of these bonds.[1]

[1] In re Wetmore, (1893) 99 Cal. 146. *Arguendo*, it was said: "The provisions of the [statute quoted in the text] are general in their character, and give to every municipal corporation incorporated under the laws of this state the power to create a bonded indebtedness for any of the purposes authorized by the act. The indebtedness is not to be incurred, nor are the bonds to be issued, until after the voters of the municipality have so directed, but as it is the vote of the electors which determines that they shall be issued, it is immaterial to them what officers of the city carry out this vote. The act itself designates the legislative branch of the municipality as the body to determine in the first instance whether the public interest or necessity demands the construction or completion of the building or improvement, and also designates that body as the agency of the corporation through whose acts the indebtedness is to be created and evidenced. There is no particular mode provided by which the council shall ascertain this fact, but in a matter which pertains to the public schools the fact would naturally be ascertained by direct communication with the board of education, or by a request from that board, and inasmuch as that board has no power to issue the bonds of the city, it is but natural to assume that it would manifest its wishes to the council. The question, however, is not how the council shall ascertain whether the public interest demands the improvement, but whether it has any power to issue the bonds after it has so determined, irrespective of the mode of ascertaining it. Although the board of education has been intrusted with the management of the schools, and it is the body designated in the charter to build the school houses, there is nothing inconsistent with this provision for the legislature to designate the council as the body to give inception to the indebtedness and issue the bonds therefor. The power to build or improve the school houses which is vested in that board is distinct from the power to borrow money with which to build or improve them. The board of education, as such, is forbidden by the charter from incurring any indebtedness beyond the annual income for school purposes, and as the Constitution permits such indebtedness by any municipal corporation only after a vote of the electors therefor, it is competent for the legislature to designate the agent or body of the municipal government which shall act for it in carrying out the will of its electors, and for this purpose the legislative branch of that government would most naturally be selected. That the education of the youth is properly included within the functions of a municipal government cannot be denied * * *. As school houses are essential aids in the promotion of education, their erection is but inci-

§ 429. The power to issue bonds under Nebraska statutes.— The Supreme Court of Nebraska reversed the lower court and ordered an injunction to issue in this action of a taxpayer to restrain the issuing, registering and selling of certain school district bonds by the board of education. They held as to the power of the school district to issue these bonds that under the law as it stood prior to April 5, 1893, a district school board, except in cities of the metropolitan class, had no power to call an election on the question of issuing bonds for purchasing sites or erecting school houses until a petition had been presented to the board suggesting that such a vote be taken and signed by at least one-third of the qualified voters of the district. The presenting of such a petition was a condition precedent to a valid election. They further held that where the law requires a petition of a certain character in order to confer power upon a board to call an election for the purpose of issuing bonds or authorizing a tax, the determination of that board is not conclusive of the sufficiency of

dental to the maintenance of the schools, and falls as completely within the functions of a municipal government as does the erection of a hospital for its indigent poor or buildings for its fire engines; and the school houses, when so erected, are as fully municipal buildings as are its engine houses and hospital buildings. Danielly *v.* Cabannis, 52 Ga. 222; Horton *v.* Mobile School Comrs., 43 Ala. 598. See, also, Board of Education *v.* Fowler, 19 Cal. 24; Board of Education *v.* Martin, 92 Cal. 209. * * * The provisions of sections 1880–1887 of the Political Code for the issuance by the supervisors of the county of school district bonds, whenever the electors of the district shall vote therefor, to pay for the building of school houses in the district, do not limit or qualify the power conferred by [the statute first mentioned] upon an incorporated city to issue its own bonds for the same purpose, notwithstanding the provisions of section 1576 of the same code, making such incorporated city a school district. Each of these acts is a general law upon a subject within legislative power, and if there is any inconsistency between them that which is later in date must prevail over the earlier act. * * * A school district has not, like an incorporated city, any financial officers, nor has it been intrusted with the power of assessment and taxation which is conferred upon an incorporated city, and for these reasons, as well as others, the legislature would naturally intrust to the supervisors of the county, as being the body having the financial supervision of the school district, the function of issuing and providing for the payment of school district bonds; and as by the Constitution bonds cannot in any case be issued except upon a vote of two-thirds of the qualified electors of the district voting upon the question of their issuance, the agency by which they might be executed would seem immaterial, and there would be little likelihood of an issuance being authorized to be made for the same purpose by each agency."

the petition or the qualifications of the petitioners. These subjects are open to inquiry in judicial proceedings to nullify the action where the parties complaining have not by acquiescence or laches estopped themselves from contesting the question.[1]

§ 430. When bonds are void under Nebraska statutes.— Certain school district bonds of a district in Nebraska were involved in this action. The statutes under which they were issued were in these words: The act of February 15, 1869, provided that "Any school district shall have power and authority to borrow money to pay for the sites of school houses, and to erect buildings thereon, and to furnish the same, by a vote of a majority of the qualified voters of said district present at any annual meeting or special meeting; provided, that a special meeting for such purpose shall be upon a notice given by the director of such district at least twenty days prior to the day of such meeting, and that the whole debt of any such district at any time, for money thus borrowed, shall not exceed five thousand dollars." The act of February 27, 1873, to provide for the registration of certain municipal bonds, provides that "* * it shall be the duty of the president or township and school district boards or officers, * * * to register with the county clerk all precinct or township and school district bonds voted and issued pursuant to * * * [certain sections of the act to establish a system of public instruction for the state]." And the section prescribes the duty of the county clerk as to the registry of such bonds. On each of the bonds sued on there was a recital that it was issued "in pursuance of an act of the legislature of the state of Nebraska, entitled 'An act to establish a system of public instruction for the state of Nebraska,' approved February 15, 1869, and acts amendatory and supplemental thereto." In the lower court there was a judgment for the school district. The United States Circuit Court of Appeals for the eighth circuit affirmed the judgment, holding that these acts did not confer

[1] Fullerton *v.* School District of Lincoln, (Neb. 1894) 59 N. W. Rep. 896. In support of the first point the court cited and quoted from State ex rel. Phillips *v.* School Dist. No. 9, 10 Neb. 544; s. c., 7 N. W. Rep. 315; Kimball *v.* School Dist. No. 4, 13 Neb. 82; s. c., 12 N. W. Rep. 812; Orchard *v.* School Dist., 14 Neb. 378; s. c., 15 N. W. Rep. 730; State *v.* Babcock, 21 Neb. 187; s. c., 31 N. W. Rep. 682; Wullenwaber *v.* Dunigan, 30 Neb. 877; s. c., 47 N. W. Rep. 420.

authority to issue negotiable securities, and that the negotiable bonds issued by the school district here were void even in the hands of an innocent purchaser.[1]

§ 431. Validity of bonds as affected by constitutional restriction upon indebtedness of municipal corporations.— The Constitution of Iowa provides as follows: "No county, or

[1] Ashuelot Nat. Bank of Keene *v.* School Dist. No. 7, Valley County, (1893) 56 Fed. Rep. 197, affirming 41 Fed. Rep. 514. THAYER, D. J., speaking for the court in support of the ruling, said: "In the case of Merrill *v.* Monticello, 138 U. S. 673, 681; s. c., 11 Sup. Ct. Rep. 441, it was held that although a municipal corporation has an implied power to borrow money and to give written evidence of the indebtedness in the form of a note or bond, yet that it has no authority, as an incident of such power, to issue a negotiable security. It was further held that the power to borrow money and the power to give a negotiable bond which may circulate in the market freed from all equitable defenses, are essentially different powers, and that the latter power will not be implied from the former. In a later case (Brenham *v.* Bank, 144 U. S. 173; s. c., 12 Sup. Ct. Rep. 559) it was held that a city which had an express power under its charter 'to borrow for general purposes not exceeding fifteen thousand dollars on the credit of the city,' had no authority, as an incident of such power, to issue negotiable securities. In accordance with that view certain negotiable bonds, in the hands of an innocent purchaser, were declared to be void, although another provision of the charter of the city declared that 'bonds of the corporation of the city of Brenham shall not be subject to tax under this act,' and although the latter clause could only have had reference to bonds issued in pursuance of the power to borrow money for general purposes on the credit of the city. In speaking of the scope of the decision in Brenham *v.* Bank, Mr. Justice HARLAN, in the dissenting opinion, says: 'It seems to us that the court in the present case announces for the first time that an express power in a municipal corporation to borrow money for corporate or general purposes does not, under any circumstances, carry with it by implication, authority to execute a negotiable promissory note or bond for the money so borrowed. * * * A declaration by this court that such notes and bonds are void because of the absence of express legislative authority to execute negotiable instruments for the money borrowed will, we fear, produce incalculable mischief.' 144 U. S. 196, 197; s. c., 12 Sup. Ct. Rep. 568. It is unnecessary for us to assert that the decision last referred to goes to the full extent last indicated, of holding that a municipal corporation can only acquire authority to issue negotiable securities, by a statute which confers such power in express language, and that the power will not be implied under any circumstances. We think, however, that we may fairly affirm that the two authorities heretofore cited do establish the following propositions: *First*, that an express power conferred upon a municipal corporation to borrow money for corporate purposes does not in itself carry with it an authority to issue negotiable securities; *second*, that the latter power will never be implied, in favor of a municipal corporation, unless such implication is necessary to prevent some express corporate power from becoming utterly nugatory; and, *third*, that in every case where a doubt arises as to the right of a municipal corporation to execute negotiable securities the doubt should be resolved against the existence of any such right. The application of these principles to the case at bar satisfies us that the judgment of the Circuit Court was for the right party and should not be disturbed."

[1] Nesbit *v.* Riverside Independent District, (1892) 144 U. S. 610. Mr. Justice BREWER, speaking for the majority of the court, said: "If not charged with knowledge of the prior indebtedness, [the holder of the bonds] was with the fact that, independent of such indebtedness, these bonds alone were an overissue and beyond the power of the district; for she was bound to take notice of the value of taxable property within the district as shown by the tax list. Buchanan *v.* Litchfield, 102 U. S. 278; Northern Bank *v.* Porter Township, 110 U. S. 608; Dixon County *v.* Field, 111 U. S. 83. In the first of these cases, on page 289, it is said that 'the purchaser of the bonds was certainly bound to take notice, not only of the constitutional limitation upon municipal indebtedness, but of such facts as the authorized official assessments disclosed concerning the valuation of taxable property within the city for the year 1873;' and in the last, on page 95, that 'the amount of the bonds was known. It is stated in the recital itself. It was eighty-seven thousand dollars. The holder of each bond was apprised of that fact. The amount of the assessed value of the taxable property is not stated, but, *ex vi termini*, it was ascertainable in one way only, and that was by reference to the assessment itself, a public record equally accessible to all intending purchasers of bonds, as well as to the county officers.' So when the plaintiff purchased these bonds she knew, or at least was chargeable with knowledge of the fact, that they were unlawfully issued and created no obligation against the district."

other political or municipal corporation, shall be allowed to become indebted in any manner, or for any purpose, to an amount in the aggregate exceeding five per centum on the value of the taxable property within such county or corporation, to be ascertained by the last state and county tax lists previous to the incurring of such indebtedness." A school district in that state, already indebted in a sum exceeding the limit named here at the time of the date of their issue, issued certain bonds in themselves aggregating a sum nearly $500 in excess of the limit. The bonds were issued at the same time and in one transaction. The whole issue were purchased in one purchase by the holder, who brought an action in the federal court upon them against the district. The United States Supreme Court held that the bonds were invalid by reason of the violation of the constitutional provision in their issue; and, further, it was held that the holder could not claim to be a *bona fide* purchaser no matter what recitals appeared on the face of the bonds.[1] The directors of a school district, the indebted-

ness of which already exceeded that allowed by the constitutional limitation, having contracted an indebtedness with certain parties, and afterwards, through collusion, permitted them to obtain judgment for the same against the school district upon proceedings to compel the authorities of the school district to levy taxes for the payment of this judgment, it was held by the Supreme Court of Iowa that the judgment was of no validity against the district and could not be enforced.[1] In an action upon certain bonds issued by a school district of Iowa in the federal court, which were held to be invalid, as in violation of the constitutional provision of that state limiting the indebtedness to be incurred by such a corporation, it was pressed upon the United States Supreme Court that a judgment obtained by the holder of these bonds, the plaintiff here, in the state court upon two coupons detached from these bonds operated as an estoppel of the district to contest the validity of the bonds in the federal court. The court held that the defense was open to the district.[2]

[1] Kane & Co. *v.* Independent School District of Rock Rapids, (1891) 82 Iowa, 5. See as to incurring indebtedness in excess of the limitation upon municipalities, the duty of creditors, the right to attack such indebtedness on the part of the municipality, etc., French *v.* City of Burlington, 42 Iowa, 614; Independent District *v.* Schreiner, 46 Iowa, 172; Kelley *v.* Town of Milan, 127 U. S. 139; s. c., 8 Sup. Ct. Rep. 1101.

[2] Nesbit *v.* Riverside Independent District, (1892) 144 U. S. 610. *Arguendo*, it was said by the court: "The law in respect to such estoppel was fully considered and determined by this court in the case of Cromwell *v.* County of Sac, 94 U. S. 351. It was there decided that when the second suit is upon the same cause of action, and between the same parties as the first, the judgment in the former is conclusive in the latter as to every question which was or might have been presented and determined in the first action; but when the second suit is upon a different cause of action, though between the same parties, the judgment in the former action operates as an estoppel only as to the point or question actually litigated and determined, and not as to other matters which might have been litigated and determined. * * * Each matured bond is a separable promise, and gives rise to a separate cause of action. It may be detached from the bond and sold by itself. Indeed, the title to several matured coupons of the same bond may be in as many different persons, and upon each a distinct and separate action be maintained. So, while the promises of the bond and of the coupons in the first instance are upon the same paper, and the coupons are for the interest due upon the bond, yet the promise to pay the coupon is as distinct from that to pay the bond as though the two promises were placed in different instruments upon different paper. By the rule laid down in Cromwell *v.* Sac County the judgment in the suit [in Iowa] is conclusive in this case only as to the matters litigated and determined. What were they? The defense pleaded was this: That at the time the bonds were issued the indebtedness exceeded five per cent, and the bonds were, therefore, void; that the district received no consideration, and that the plaintiff was not a *bona fide* holder. The judgment entry shows that it appeared from the evidence that the indebtedness at the time the bonds were issued exceeded the constitutional limitation of five per cent, but that it was adjudged that the recitals in the bonds estopped the defendant from showing this fact against the plaintiff. In other words, that which was determined was the effect of the recitals. But this case does not turn upon that question at all, and nothing was determined here antagonistic to the adjudication there. An additional fact, that of notice from the amount of the bonds purchased, was proved. The effect of recitals in municipal bonds is like that given to words of negotiabilty in a promissory note. They simply relieve the paper in the hands of a *bona fide* holder from the burden of defenses other than the lack of power, growing out of the original issue of the paper, and available as against the immediate payee. * * * In the suit [in Iowa] no notice to the holder was shown. The recitals cut off the defense pleaded of original invalidity. In this action notice is proved, and an additional fact is put into the case which makes a new question. The effect of recitals is one thing; that of recitals coupled with notice is another. The one question was litigated and determined in [the Iowa] suit; the other is presented here. Surely an adjudication as to the effect of one fact alone does not preclude in the second suit an inquiry and determination as to the effect of that fact in conjunction with others. * * * It was well said in Cromwell *v.* County of Sac, page 356, that 'Various considerations other than the actual merits may govern a party in bringing forward grounds of recovery or defense in one action which may not exist in another action upon a different demand, such as the smallness of the amount, or the value of the property in controversy, the difficulty of obtaining the necessary evidence, the expense of the litigation and his own situation at the time. A party acting upon considerations like these ought not to be precluded from contesting in a subsequent action other demands arising out of the same transaction.' This case may be looked at in another light. The defense pleaded in [the Iowa] suit was, that at the time of the issue of the two bonds then disclosed, there was a prior indebtedness of the district exceeding the constitutional limitation; and that defense was the one adjudged to be precluded by the recitals. Here are additional defenses, that the five bonds in suit themselves created an overissue. That question was not presented in [the Iowa] suit, and could not have been adjudicated. It is presented for the first time in this case. It is of itself a valid defense, irrespective of prior indebtedness. So we have in this case a new question not presented in [the Iowa] suit, the existence of facts never called to the attention of the court in that case, which of themselves create a perfect defense."

§ 432. Bonds secured by a pledge of school fund and property.— The bonds of a city of Kansas issued by the board of education of the city, secured by a pledge of the school fund and property of the city with coupons attached, have been held

by the United States Supreme Court to be valid obligations of the municipal corporation.[1]

§ 433. Conditions precedent to the issue of bonds.— In a case from Kansas involving the validity of certain bonds issued by the board of education of the city, which required the consent

[1] Atchison Board of Education *v.* De Kay, (1893) 148 U. S. 591. Mr. Justice BREWER, speaking for the court, after reviewing the Kansas legislation as to cities, stated the objections to the validity of the bonds and replied to them as follows: "*First*, it is objected that the bond purports to be issued under authority of an act entitled, 'An act to organize cities,' etc., approved February 28, 1868; that no such act is to be found in the statutes of that year, and that, therefore, the bonds were issued without authority of law, and are not valid obligations. This is trifling. There was an act giving authority to the board of education to borrow money and issue bonds, and whose title was exactly as described in this bond, except in place of the word 'organize' the word 'incorporate' was used. *Falsa demonstratio non nocet*. Commissioners *v.* January, 94 U. S. 202. An error in copying into an instrument a single word in the title of a statute does not vitiate the deliberate acts of the proper officers of a municipality as expressed in the promise to pay, which they have issued for money borrowed. Again, it is insisted that the board of education had no power to bind the city of Atchison as a municipal corporation, but only that other and *quasi* corporation known as school district No. 1, Atchison county. The argument is that there were two corporations: *First*, a school district corporation whose name and corporate existence were prescribed by the Laws of 1858; and another, a strictly municipal corporation, known as the city of Atchison, with the ordinary powers attached to such a municipality; that though they embraced within their limits the same territory and population, they were in fact distinct corporate entities, and that the board of education, having control of the affairs of the corporation, had no power to bind the other by its promise to pay." The court said: "It may well be doubted whether there were two distinct corporations. Section 14 of the acts of 1867 and 1868, incorporating cities of the second class, provided that 'each city shall constitute at least one school district.' There is no pretense, under the power reserved in that section, that the city of Atchison was ever divided into districts; so, by that section, Atchison city constituted a school district. The members of the board of education were to be elected at the annual city election, and to the board was given full control of the school affairs of the city. Section 57. In other words, it was the city's schools and the city's school property, which were placed under the management of the board of education. Upon the report of the board of education the city council levied and collected the school taxes (section 67), and when they were collected they were retained by the city treasurer in his custody. Section 68. The title to all school property was vested in the city. Section 70. No bonds could be issued without the consent of the city council. Section 76. And the school fund and property of such city is pledged to the payment of the bonds. Section 81. The whole idea of the statute seems to have been the mingling of the schools and the school interest with the ordinary municipal functions of the city of Atchison, giving to the board of education, as an administrative body of the city, the management of the schools and the school property. Further, when in 1872 a new act was passed in respect to the incorporation of cities of the second class, * * * it was expressly provided that 'the public schools of such city organized in pursuance of this act, shall be a body corporate, and shall possess the usual powers of a corporation for public purposes by the name and style of 'The Board of Education of the city of ——, of the state of Kansas,' and in that name may sue,' etc. The legislation seems to imply that up to that time there was in cities of the second class no separate school corporation. But even if this be a misconstruction of the statute, it is clear that the school district and the city were coterminous; that, by the act of 1868, the board of education was authorized to borrow on the credit of the school property, with the consent of the city council, and to issue bonds in payment therefor. They did proceed, as appears from the recital in the bonds, under authority given by that act, and if there were a misrecital of the name of the obligor, such mere misrecital would not vitiate the obligations. Proceeding strictly under that act, they bound the corporation whose officers they were and for which they assumed to act, and whether the name of that corporation was technically 'The City of Atchison' or 'School District No. 1, Atchison County,' by the issue of bonds they bound that corporation."

[1] In support of this position the case of Newman *v.* Emporia, 32 Kans. 456, was cited.

[2] In support of these last positions the cases of Paola & Fall River Railroad *v.* Anderson County Comrs., 16 Kans. 302, and Aikman *v.* School District, 27 Kans. 129, were cited.

[3] Atchison Board of Education *v.* De Kay, (1893) 148 U. S. 598. Mr.

of the city council, the record showed a number of meetings of a part of the council, and adjournments to subsequent dates, one of these adjournments when only the clerk of the council was present. At a final meeting the mayor and five councilmen, being a majority of the council, were present, and a resolution was passed giving the consent of the council to the issue of these bonds. It was insisted before the United States Supreme Court that consent could only be given by an ordinance, and not by resolution.[1] Further, it was contended that even if a resolution were sufficient, there was no legal meeting of the council, because all the members were not present, and it did not appear that all were notified, or that a special meeting had been called; that it was not a regular, but apparently an adjourned meeting; and that the first adjournment was without validity because none of the councilmen were present, and the adjournment was ordered by the clerk alone.[2] The Supreme Court held these bonds to be valid.[3]

§ 434. The adoption of a statute to obtain authority to issue bonds — mode of calling election.—The adoption, by a vote of the electors of a city, at an election duly called in accordance with the provisions of the city charter, of an act relating to schools pursuant to the provisions of that act, the United States Circuit Court of Appeals for the eighth circuit held was not void because a resolution of the city council calling the election, which was not required by any provision of the statute or the charter, never took effect because it was not legally published. The bonds sued upon in this action were issued under the act referred to above relating to schools, and it was contended that it was never legally adopted by the city, and the bonds were, therefore, void.[1]

Justice BREWER, speaking for the court, said: "In respect to the first of these contentions the general rule is that where the charter commits the decision of a matter to the council, and is silent as to the mode, the decision may be evidenced by a resolution, and need not necessarily be an ordinance. State *v.* Jersey City, 27 N. J. L. 493; Butler *v.* Passaic, 44 N. J. L. 171; Barb Wire Co. *v.* Chicago, Burlington, etc., Railway, 70 Iowa, 105; Sower *v.* Philadelphia, 35 Pa. St. 231; Gas Company *v.* San Francisco, 6 Cal. 190; First Municipality *v.* Cutting, 4 La. Ann. 335; Green Bay *v.* Brauns, 50 Wis. 204; 1 Dill. Mun. Corp. (4th ed.) § 307 and notes. Nor is there anything in [Newman *v.* Emporia, 32 Kans. 456] in conflict with this. That simply holds that where a charter requires that certain things be done by ordinance they cannot be done by resolution. In this act incorporating cities of the second class there is nothing which either in terms or by implication requires that the consent of the city council shall be given only by ordinance. A resolution was, therefore, sufficient." As to the contentions as to the meetings of the council and the adjournment by the clerk of one of them, it was said: "The act of 1868, section 13, provides that regular meetings of the city council shall be held at such times as the council may provide by ordinance. No evidence was offered showing what were the dates of regular meetings, as provided by ordinance. We are led to infer that these meetings were not regular meetings from the language at the commencement of the records thereof — 'that council met pursuant to adjournment.' The first adjournment was made by the city clerk alone, no member of the city council being present. We are not advised by the testimony as to what rules, if any, had been prescribed by the city council in respect to such matter. It is not an uncommon thing for legislative bodies, such as a city council, to provide by rules that, in the absence of all members, the clerk or secretary shall have power to adjourn. That probably such a rule as that was in existence is evidenced by the fact that at succeeding meetings, which, giving full weight to the language used at the commencement of the record, were simply adjourned meetings, the council, all but one of whom were present at one of the meetings, approved the records. All these entries of meetings appear to have been kept upon the regular record of the city council, and it is obvious that either because an adjournment by the clerk in the absence of the council was authorized by rule, or because the days of the subsequent meetings were, in fact, the regular days therefor, such meetings were accepted and recognized by the council as legal. Certain it is that when bonds have been issued in reliance upon a consent thus evidenced, and when for years thereafter interest has been duly paid upon such bonds, the court will not, after the lapse of twenty years, in a suit on the bonds, pronounce them invalid on such technical and trivial grounds." The court then distinguished the cases relied on on behalf of the city (Paola & Fall River Railroad *v.* Anderson County Comrs., 16 Kans. 302, and Aikman *v.* School District, 27 Kans. 129) to show that they did not militate against the views of the court, before given, as follows: "In the case in 16 Kansas, which was an action by the county against the railway company to cancel a subscription for stock, and for the return and cancellation of bonds of the county on deposit with the state treasurer, the matter was submitted on demurrer to the petition and that petition averred that the subscription was ordered at a special session of the board, at which only two of the three commissioners were present; that no call for such session was made, nor anything done to authorize a call; that B. M. Lingo, the absent commissioner, was in the county, at his residence, but had no knowledge or notice of such intended special session; 'that knowledge and notice of such intended special session was intentionally and fraudulently concealed and kept from said B. M. Lingo by the said railway company and its agents; and said session was not a regular session of said board, nor was it an adjourned session from any regular session thereof, nor from any duly called special session of said board.' The court held that the subscription ordered under those circumstances was not binding upon the county. In that case the contract was executory, and the bonds had not been delivered, but were still within the control of the county. The special session, with only a fraction of the board present, was fraudulently intended and fraudulently brought about, and the railway company was the wrongdoer. The illegality of the session was not a matter of inference, but a fact alleged and admitted. The case in 27 Kansas is even stronger. That was a suit on a written contract, signed by two members of a school district board, the board consisting of three. Such a contract could only be made by the district board as a board. It appeared affirmatively that there was no meeting of the board; that it was signed by the two members, not after consultation, but by each separately, and at a different time from the other."

[1] National Life Ins. Co. of Montpelier *v.* Board of Education of City of Huron, (1894) 62 Fed. Rep. 778. The court distinguished National Bank of Commerce *v.* Town of Granada, 54 Fed. Rep. 100; s. c., 4 C. C. A. 212, cited in support of the contention, in these words: "In that case the bonds were issued under [a statute] of Colorado which expressly provides that the city council or board of trustees shall call the election and shall publish the notice of the election to determine whether or not the bonds shall issue, and shall then issue the bonds if the vote is favorable. The board of trustees of the town of Granada passed an ordinance which in itself called the election, presented the notice and authorized the mayor and clerk to issue the bonds if the vote was favorable. A general statute of the state provided that such an ordinance should be published and that it should not take effect

§ 435. When non-compliance with the requirements of the Constitution of the state is not a defense against bona fide purchasers.— In a late case before the United States Circuit Court of Appeals for the eighth circuit, the board of education, authorized to issue bonds, issued them without complying with a constitutional requirement of South Dakota that, at or before the time of incurring such indebtedness, provision should be made for the collection of an annual tax to pay interest and principal, although the board had full power to make such provision. The bonds recited "that all conditions and things required to be done precedent to and in the issuing of said bonds have duly happened and been performed in regular and due form as required by law." The court held that the non-compliance with such requirement was not available to the board as a defense against *bona fide* purchasers of the bonds. This board were authorized to issue bonds for certain purposes and to sell them for not less than ninety-eight cents on the dollar. They issued bonds purporting to be for such purposes, but, in fact, for an unauthorized purpose, accepted a bid from an individual for the bonds at par, and delivered them to him, received part of the price, and

until five days after its publication. The ordinance never was published, and the court held that it was never in force, and that the mayor and clerk never had any authority to issue the bonds; that it was a case of total want of authority on their part to act upon any conditions. McClure *v.* Township of Oxford, 94 U. S. 429, is a similar case of want of authority, because in that case the statute had not taken effect before the notice of election was given, so that there was no authority to give it. But these cases have no relevancy to the question presented here. In the case of the Town of Granada the statute required the board of trustees to call the election and to publish the notice of it. There is no such provision relative to the election for the adoption of article 3 in any of the statutes under which the bonds were issued. That article provides that any organized city may at any time adopt the provisions of the act by a majority vote of the electors. It is silent as to the person or body that shall call the election and as to the notice of it." The facts are then stated as to the election called here, and it is said: "At that election the electors voted, the city council subsequently canvassed and declared the vote, and all parties treated it as a valid election until they came to pay these coupons. In that election every requirement of the charter and of the statute was complied with, and in our opinion the election was valid and article 3 was duly adopted. If the city council had passed no resolution calling the election, it would yet have been called and held in strict accordance with the charter, and that election cannot be invalidated by the fact that the city council passed a futile resolution that never took effect."

transferred its right to the balance to the city, receiving a city warrant for the amount. This individual, whose bid was accepted by the board, sold the bonds for ninety-seven and a half cents on the dollar. The court held that this constituted an executed sale of the bonds to this individual at par, and purchasers from him, who were strangers to his purchase from the board, were not chargeable with notice of the invalidity of the bonds, because they supposed they were buying from the board. And, as against innocent purchasers for value, before maturity, of bonds issued by a city board of education, it was no defense that the board loaned nearly the entire proceeds of their sale to the city for city warrants that were never paid, and that could not be legally enforced.[1]

§ 436. When the defense that the site of the school house was not owned by the district is not open in a bona fide holder's action on the bonds.— One of the most recent cases involving the question of what defenses are open in actions upon municipal bonds by *bona fide* purchasers and owners was one involving the liability of a school district in North Dakota upon bonds issued under a special act of the legislature authorizing the issuance of bonds. The Supreme Court of that state held that there was no error in rejecting the offer on the part of the defendant to prove that the land on which the school building for which the bonds in suit were issued was situated was not owned by the defendant or its school board, which was a condition prescribed in the statute to the issuing of bonds; that it had never been conveyed to the district or its school board; that proceedings to condemn it as a school site had never been instituted; and that it was in fact the property of a third person. There was an express provision in an amendment to the special act that the indebtedness of no school district mentioned in the original act should be bonded until the land on which the school

[1] National Life Ins. Co. of Montpelier *v.* Board of Education of the City of Huron, (1894) 62 Fed. Rep. 778. SANBORN, Circuit Judge, further said: "That a municipal corporation has given away or squandered the proceeds of negotiable securities which it placed upon the market, cannot affect the rights of *bona fide* purchasers who had no knowledge of, nor part in, the gift or waste. They are in no way responsible for the wise and economical use by the corporation of the funds it borrows. County Comrs. *v.* Beal, 113 U. S. 227, 240; s. c., 5 Sup. Ct. Rep. 433; Cairo *v.* Zane, 149 U. S. 122, 137; s. c., 13 Sup. Ct. Rep. 803; Maxcy *v.* Williamson Co., 72 Ill. 207."

building was located should have been conveyed by good and sufficient warranty deed to the school board of such district, or the title to it should have been obtained by the school board by proper condemnation in the manner prescribed by law. The Supreme Court said of this: "The existence of this fact of ownership of the site on which the school building was situated was a condition precedent to the existence of any power to issue bonds. Until this fact existed, the district was as powerless to bond as if no statute on the subject had been passed." Then it was said: "The only possible escape of the plaintiff from this conclusion is by invoking another doctrine — the doctrine of estoppel from recitals in the bonds or in a certificate attached to it." Upon each bond was indorsed a certificate signed by the county clerk, certifying that such bond "is issued in accordance with law and by authority of a majority of the legal voters of said district present and voting at an election duly held May 11, 1885, for that purpose, and is duly registered in this office." The court held that the school district was estopped by this recital to make the defense suggested.[1]

§ 437. When the defense that the proceeds of bonds were used for another purpose is not open in such an action.— It was held in this case that it was not a defense to the bonds, as against *bona fide* purchasers of them, that the citizens and officers of the municipal corporation, with intention to use the proceeds of the bonds for an unlawful purpose, took the necessary steps to issue them for a lawful purpose, certified on the face of them that they were issued for such lawful purpose, and then appropriated the proceeds to an unlawful purpose.[2]

Flagg *v.* School District No. 70, (N. D. 1894) 58 N. W. Rep. 499. The doctrine of estoppel is very fully discussed in the opinion rendered by the court.

[2] National Life Ins. Co. of Montpelier *v.* Board of Directors of City of Huron, (1894) 62 Fed. Rep. 778. The court said: "Corporations are as strongly bound to an adherence to truth in their dealings with mankind as are individuals, and they cannot, by their representations or silence, induce others to part with their money or property and then repudiate the obligations for which the money was expended, and which their statements represented to be valid. The defendant, in its resolutions and records, in all the resolutions and records of the city council of Huron, in the call for and vote at the election which authorized the issue of the bonds, and in the bonds themselves, declared that they were issued for a lawful purpose, viz., 'To raise funds for the purchase of a school site and for the erection of a school building thereon.' The present holders purchased them and paid for them with no notice or knowledge that they were issued for any other purpose, and in the full belief that these declarations were true. It is no defense, as against these *bona fide* purchasers, that this corporation, during all this time, intended to use, and has since used, the money it raised from these bonds for the unlawful purpose of conducting a campaign for the state capitol. It is no defense that it knew at the time it was taking these proceedings and making these declarations that they were false, and that during all this time it intended, *first*, to deprive itself of the school site and building; and, *second*, to deprive the purchasers of the bonds of the moneys they paid for them on the faith of its representations, and that it has accomplished the former purpose, and now seeks, with the aid of the courts, to accomplish the latter. Such a plea cannot be entertained in a court of justice. The corporation is estopped to deny that these bonds were issued to raise money for a school site and school buildings. Moran *v.* Commissioners, 2 Black, 722; Hackett *v.* Ottawa, 99 U. S. 86, 90; Ottawa *v.* National Bank, 105 U. S. 342, 345; Zabriskie *v.* Railroad Co., 23 How. 381; Omaha Bridge Cases, 10 U. S. App. 101, 189; s. c., 2 C. C. A. 174; 51 Fed. Rep. 309; Paxson *v.* Brown, 61 Fed. Rep. 874, and cases cited."

§ 438. What does not create an estoppel of the district to defend.— In case the officers of a school district, without lawful authority, borrow and expend money for the completion of a school house, the Supreme Court of Minnesota has held that no liability attaches to the district therefor, notwithstanding the benefit received from the expenditure, and that no estoppel or ratification can be inferred from the retention or enjoyment of the improvement by the school district, as it had no option to reject the improvement.[1] In an action upon certain school district bonds received in exchange for bonds, which were void under the provisions of the Constitution of Iowa limiting the amount of indebtedness of counties and municipal corporations to five per cent of the value of taxable property therein, it appeared that the bonds were issued to the owner of the old bonds, not a *bona fide* holder, under an act of the legislature of that state empowering school districts to issue refunding bonds. The federal court held that no estoppel arose, from recitals in the refunding bonds, to prevent a showing that the constitutional limitation was

[1] Young *v.* Board of Education of Independent School District No. 47, (Minn.) 55 N. W. Rep. 1112. It was said by the court: "It would be a very unsafe rule to establish to hold that school officers might borrow money at their pleasure, and bond the district because the same is expended by them in improving the property of the district. The case is to be distinguished from Borough of Henderson *v.* County of Sibley, 28 Minn. 515; s. c., 11 N. W. Rep. 91. There the money claimed had been deposited in the county treasury, and was used and expended by the county in the erection of a court house, which it had authority to

exceeded in the prior issue. Further, the purchaser of such refunding bonds was bound to take notice of the listed value of the property of the school district.[1]

§ 439. One of the latest decisions on the effect of recitals in bonds.—In a very late case as to the effect of recitals upon the face of bonds issued by municipal corporations upon the rights of *bona fide* holders of such bonds, the United States Circuit Court of Appeals for the eighth circuit, as their conclusion after a review of many of the leading cases upon this subject, declared these rules: Where a municipal body has lawful authority to issue bonds or negotiate securities, dependent only upon the adoption of certain preliminary proceedings, and the adoption of those preliminary proceedings is certified on the face of the bonds by the body to which the law intrusts the power and upon which it imposes the duty to ascertain, determine and certify this fact before or at the time of the issuing of the bonds, such a certificate will estop the municipality, as against a *bona fide* purchaser of the bonds, from proving its falsity in order to defeat them. Such an estoppel may arise in a proper case, upon a recital that an act required by a Constitution has been performed, as well as upon a recital of the performance of an act required by statute. Recitals in municipal bonds may constitute an estoppel in favor of a *bona fide* purchaser, even where the body that issued the bonds had no power to issue them, and could not, by any act of its own or of its constituent body, make a lawful issue of the bonds, if the fact of this want of power does not appear from the bonds the purchaser buys, the Constitution and statutes under which they are issued nor the public records referred to therein. But recitals in municipal bonds by the representative body that issues them, to the effect that all the requirements of the laws with reference to their issue have been complied with, will not estop the municipality from proving, as against a *bona fide* purchaser, that the representative body had no power to issue them where no act of the representative or constituent body could make

build. It was expended for a lawful purpose by the proper authorities, and the county could not deny that it had, or had used for its benefit, plaintiff's money received without consideration, and was bound to refund."

[1] Shaw *v.* Independent School Dist. of Riverside, (1894) 62 Fed. Rep. 911, following Doon Township *v.* Cummins, 142 U. S. 366; s. c., 12 Sup. Ct. Rep. 220, reversing Cummins *v.* District of Doon, 42 Fed. Rep. 644.

the issue lawful at the time it was made, and this fact appears from the Constitution and statute under which the bonds are issued, the public records referred to therein and the bonds the purchaser buys.[1]

[1] National Life Ins. Co. of Montpelier *v.* Board of Education of City of Huron, (1894) 62 Fed. Rep. 778. The cases reviewed and cited by the court from which they drew their deductions were: Dixon Co. *v.* Field, 111 U. S. 83; s. c., 4 Sup. Ct. Rep. 315; Sutliff *v.* Commissioners, 147 U. S. 230; s. c., 13 Sup. Ct. Rep. 318; Northern Bank of Toledo *v.* Porter Tp. Trustees, 110 U. S 608; s. c., 4 Sup. Ct. Rep. 254; McClure *v.* Township of Oxford, 94 U. S. 429; Lake Co. *v.* Graham, 130 U. S. 674; s. c., 9 Sup. Ct. Rep. 654; Nesbit *v.* Independent District, 144 U. S. 610; s. c., 12 Sup. Ct. Rep. 746; Hedges *v.* Dixon Co., 150 U. S. 182; s. c., 14 Sup. Ct. Rep. 71; Marsh *v.* Fulton Co., 10 Wall. 676; Buchanan *v.* Litchfield, 102 U. S. 278; Pana *v.* Bowler, 107 U. S. 529; s. c., 2 Sup. Ct. Rep. 704; Oregon *v.* Jennings, 119 U. S. 74; s. c., 7 Sup. Ct. Rep. 124; Chaffee Co. *v.* Potter, 142 U. S. 355; s. c., 12 Sup. Ct. Rep. 216; Commissioners *v.* Aspinwall, 21 How. 539; Bissell *v.* City of Jeffersonville, 24 How. 287; Moran *v.* Commissioners, 2 Black, 722; Meyer *v.* City of Muscatine, 1 Wall. 384, 393; Lee Co. *v.* Rogers, 7 Wall. 181; Pendleton Co. *v.* Amy, 13 Wall. 297, 305; City of Lexington *v.* Butler, 14 Wall. 282; Grand Chute *v.* Winegar, 15 Wall. 355; Lynde *v.* Winnebago Co., 16 Wall. 6; Marcy *v.* Township of Oswego, 92 U. S. 637; Town of Coloma *v.* Eaves, 92 U. S. 482; County of Moultrie *v.* Rockingham Ten Cent Sav. Bank, 92 U. S. 631; Commissioners *v.* Bolles, 94 U. S. 104; Commissioners *v.* Clark, 94 U. S. 278; Commissioners *v.* January, 94 U. S. 202; County of Warren *v.* Marcy, 97 U. S. 96.

CHAPTER XXII.

MUNICIPAL AID BONDS — COUNTY.

§ 440. County aid bonds, generally.
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§ 440. County aid bonds, generally.— The governing boards of counties, where the authority has not been conferred upon them to issue bonds in payment of a subscription to stock of a railroad company by an election properly called, will not be compelled to issue such bonds.[1] Under authority for the issue of bonds of municipal corporations and apply their proceeds as subscription to railroad stock, the railroad company to be aided thereby may take the bonds themselves at par in exchange for stock.[2] When

[1] Schuyler County *v.* People, 25 Ill. 181; Clarke *v.* Supervisors of Hancock County, 27 Ill. 305; Fulton County *v.* Mississippi & Wabash Railroad, 21 Ill. 373; People *v.* Tazewell County, 22 Ill. 147. The Court of Appeals of Virginia upheld the power of a county to subscribe for stock to a railroad company under the provisions of the charter of the company and its amended charter, and affirmed a judgment dismissing the bill praying to enjoin the issue and sale of bonds for the purpose of paying the subscription in Powell *v.* Supervisors of Brunswick County, (1892) 88 Va. 707. See, also, Taylor *v.* Board of Supervisors, 86 Va. 506.

[2] Decker *v.* Hughes, 68 Ill. 33. Subscriptions to stock of railroad or other corporations entitled thereto under authority of the legislature by municipal corporations must conform to the mode prescribed in the law. W. & Mt. S. P. R. Co. *v.* Clarke County Ct., 3 Metc. (Ky.) 143; Mercer Co. Ct. *v.* Ky. River Navigation Co., 8 Bush (Ky.), 307.

[1] Johnson *v.* County of Stark, (1860) 24 Ill. 75.

[2] Thomas *v.* Morgan County, 59 Ill. 479.

[3] Board of Supervisors of Mercer County *v.* Hubbard, (1867) 45 Ill. 139. As to what will not operate to estop a county from denying that an election in favor of aid to a railroad company was properly held, or to relieve the company claiming the benefit of the subscription from the burden of showing that the election was properly held, see People *v.* Jackson County, 92 Ill. 441. An act of Kansas authorizing the issue of bonds held unconstitutional and the bonds held void. C. B. U. P. R. R. Co. *v.* Smith, 23 Kans. 745. When a corporation is qualified to accept the benefits of the Kansas statute enabling municipal townships to subscribe to stock, etc., of railroad companies. Atchison, Topeka & Santa Fe R. R. Co. *v.* Jefferson County, 21 Kans. 309. When an action can be maintained by a county to have bonds surrendered for cancellation as not being legal and binding upon the county. Anderson County *v.* Paola & Fall River Ry. Co., 20 Kans. 534; P. & F. R. Ry. Co. *v.* Anderson County, 16 Kans. 302. Donation of land by a county to a railroad company in aid of its construction held absolutely void, though author-

the steps have been taken required by a statute authorizing an issue of bonds by a county in payment of a subscription to the stock of a railroad company, the provisions of the statute being fully complied with, and the denomination of the bonds not specified in the statute, a county may issue one bond or more, as the authorities may find convenient or deem proper. Should the authorities afterwards take up one bond which they may have issued covering the whole amount, and in exchange for it issue a greater number in smaller denominations covering the subscription, and the county, by its action, subsequently recognize the issuance of the bonds in smaller denominations given in exchange, this will be deemed a satisfaction of the bonds.[1] The stipulation between a railroad company and a county issuing its bonds to the company, upon delivering them to the bankers of the company, that the bonds were to be applied in payment for work done within the county and not elsewhere, has been construed to mean, in view of this purpose, not that these identical bonds should pay for work done in that county, but that if work was done in the county the bonds should be delivered to the company.[2] Should a county receive stock in a railroad company to the full amount of its subscription, and vote its stock and pay interest on the bonds issued in payment of its subscription, the county cannot be heard to say that it was not liable to pay accruing interest on the bonds.[3] The Supreme Court of Tennessee has held that the fact

that the act of the legislature authorized the bonds to be issued in aid of a railroad company, bearing interest at the legal rate where they were payable, in another state where the rate of interest allowed was larger than in Tennessee, did not render the bonds void for usury.[1] A railroad company receiving bonds of a county on a subscription to its preferred stock, and agreeing to pay the interest on the same until the road should be completed into the county, will not be bound for the interest after the county has received and become entitled to interest on its preferred stock, though the stock may have been received before the completion of the road into the county.[2] And the county having received the stock, in an action to recover such interest from the company, will be estopped to set up that the road had not been completed, or that the act of the county authorities in receiving the stock was *ultra vires*.[3]

ized by the legislature, in Ellis *v.* Northern Pac. R. R. Co., 77 Wis. 114; s. c., 45 N. W. Rep. 811. As to the constitutionality of the act of the legislature of Kansas authorizing aid to railroad companies by subscription to stock of, and issue of bonds to, such companies, see Morris *v.* Morris County, 7 Kans. 576. That the preliminary steps to a subscription and issue of bonds prescribed by the act authorizing it must be strictly taken, see Lewis *v.* Bourbon Co., 12 Kans. 186.

[1] Nelson *v.* Haywood County, 3 Pickle, 781; s. c., 11 S. W. Rep. 885.

[2] County of Lancaster *v.* Cheraw & C. R. R. Co., 28 S. C. 134; s. c., 5 S. E. Rep. 338.

[3] Ibid. As to the authority of municipal corporations to make donations in aid of railroads, see Madry *v.* Cox, 73 Tex. 538; s. c., 11 S. W. Rep. 541; MacKenzie *v.* Wooley, 39 La. Ann. 944. As to the right of taxation and the duty of the authorities for the payment of subscriptions to stock of railroads by municipal corporations, see Meriwether *v.* Muhlenburg Co. Ct., 120 U. S. 354; s. c., 7 Sup. Ct. Rep. 563; Bartemeyer *v.* Rohlfs, 71 Iowa, 582; s. c., 32 N. W. Rep. 673; Chicago, M. & St. Paul Ry. Co. *v.* Hartshorn, 30 Fed. Rep. 541. Where it was held that an agreement by the railroad company to which aid was voted under the Kansas statutes, executed after the subscription of the county, to sell and transfer its road after it was completed, in order to obtain money for its construction, did not discharge or release the county from the payment of its subscription, see Southern Kansas & P. R. R. Co. *v.* Towner, 41 Kans. 72; s. c., 21 Pac. Rep. 221. That taxpayers may be estopped to deny the validity of a tax voted in aid of a railway corporation by a municipal corporation by an expenditure on the part of the railroad corporation of large sums in the construction of its road, and the taxpayers making no objection, see Johnson *v.* Kessler, 76 Iowa, 411; s. c., 41 N. W. Rep. 57. Aid bonds were issued by a county in West Virginia, and placed in the hands of three citizens of the county as a committee, to be delivered in such amounts as in their judgment would be a fair compensation for work done in the county upon the road, on which work these bonds were to be expended. The Supreme

Where an unconditional subscription has been made by a county to stock of a railroad company, under legal authority, the contract will be complete, and creditors of the company may rely upon it for payment of their debts as implicitly as upon any other assets of the company, although the company may subsequently abandon all proceedings under its charter on account of its insolvency.[1] And the president of the railroad company, while he might bind himself, and the creditors and stockholders of the company might bind themselves, by an agreement to treat a subscription of this sort as conditional, so far as their respective rights are concerned, the president has no right or authority to make such an agreement so as to prejudice the company or its creditors.[2] The Supreme Court of Alabama, one justice, however, dissenting, has held that under the Constitution of that state, the legislature has power to authorize a county, as a body corporate, to subscribe for stock in a railroad company, if the people chose to do so, by a popular vote to that effect. Also, they held that for the payment for the stock so subscribed, the county, as a corporation, might be authorized and required to issue bonds of the county and deliver them to the railroad company, to the stock of which the county might subscribe, in the manner prescribed by law.[3] All reasonable presumptions will be indulged in favor of the regularity of county bonds issued and put into circulation upon subscription to the stock of a railroad company, until overcome and rebutted. Even if irregularities are shown, the bonds will

Court held that the contract of the county was not impaired by the County Courts' adopting an ordinance requiring the bonds still undelivered to be countersigned by the president of the County Courts, who should concur in and approve their delivery, the committee being mere agents of the county. Satterlee *v.* Strider, 31 W. Va. 781; s. c., 8 S. E. Rep. 552.

[1] Morgan County *v.* Thomas, 76 Ill. 120.

[2] Ibid.

[3] Ex parte Selma & Gulf Railroad Co., (1871) 45 Ala. 696. That a legislature has the constitutional right to authorize counties and cities to become shareholders in railroad companies, see Johnson *v.* County of Stark, (1860) 24 Ill. 75; followed in Perkins *v.* Lewis, (1860) 24 Ill. 208. That the building of a railroad is a corporate purpose for which subscription may be made to the stock of and bonds issued to a railroad corporation, see Nichol *v.* Mayor & Aldermen of Nashville, 9 Humph. (Tenn.) 252; Louisville & Nashville R. R. Co. *v.* County Court, etc., 1 Sneed (Tenn.), 637; Goddin *v.* Crump, 8 Leigh (Va.), 120; Talbot *v.* Dent, 9 B. Mon. (Ky.) 526; Thomas *v.* Leland, 24 Wend. 65; Slack *v.* Maysville & Lexington R. R. Co., 13 B. Mon. (Ky.) 1; Commonwealth *v.* McWilliams, 1 Jones (Pa.), 61; People *v.* Mayor of Brooklyn, 4 Comst. 419; Shaw *v.* Dennis, 5 Gilm. (Ill.) 405.

not be invalidated thereby unless they go to the power of the authorities of the county to issue them.[1] In an Alabama case the Supreme Court held that mere irregularities, not fraudulent, which may have intervened in the exercise of the authority to make the subscription and issue the bonds for its payment, must be held to be waived, if not objected to prior to the issuance of the bonds and the performance by the railroad corporation of its part of the duty imposed, in consideration of the aid thus afforded.[2] A bond purporting upon its face to be issued under

[1] Maxcy *v.* Williamson County, 72 Ill. 207.

[2] Fielder *v.* Montgomery & Eufaua R. R. Co., (1874) 51 Ala. 178, affirming a dismissal of the bill praying an injunction in this case. *Arguendo*, the court said: "It seems now to be the settled law that where the power to make the subscription and to issue the bonds, or to impose a tax necessary for its payment, is once shown to exist, the obligation to pay cannot be denied or repudiated. The consent to the 'subscription,' is a consent to the issuance of the bonds, and an obligation to pay them, and it is a consent also to the tax necessary for this purpose, if that is the mode allowed by law for raising the funds required for their payment. Ex parte Selma & Gulf R. R. Co., 45 Ala. 696, 730, 731. Here the corporations were fully organized on both sides, and capable of contracting to the full extent of the obligations each undertook to perform; and they substantially pursued the mode authorized by law for this purpose. Speaking upon this important question the Supreme Court of the United States, quoting the language of the Supreme Court of Wisconsin, says: 'The power of municipal corporations when authorized by the legislature to engage in works of internal improvement, such as the building of railroads, canals, harbors, and the like, or to loan their credit in aid thereof, and to defray the expenses of such improvements, and make good their pledges by an exercise of the power of taxing the persons and property of their citizens, *has always been sustained*, on the ground that such works, although they are in general operated and controlled by private corporations, are, nevertheless, by reason of the facilities which they afford for trade, commerce, and intercommunication between different and distant portions of the country, indispensable to the public interests and public functions. It was originally supposed that they would add, and subsequent experience demonstrated that they have added, vastly and almost immeasurably, to the general business, commercial prosperity, and pecuniary resources of the inhabitants of cities, towns, villages, and rural districts through which they pass and with which they are connected. It is in view of these results, the public good thus produced, or other benefits thus conferred upon the persons and property of all the inhabitants composing the community, that courts have been able to pronounce them matters of public concern, for the accomplishment of which the taxing power might lawfully be called into action.' Olcott *v.* The Supervisors, 16 Wall. 678. 691, 692; Hasbrouck *v.* Milwaukee, 13 Wis. 37. In this important case, the highest judicial tribunal in the nation declares, in effect, that if the power to make the subscription, and to issue the bonds for its payment, *exists at the time of the subscription and issuance of the bonds*, their obligation must be complied with, and this obligation will be enforced by the national power."

[1] C. B. U. P. R. R. Co. *v.* Smith, 23 Kans. 745.

[2] Marion County *v.* Harvey, County, 26 Kans. 181.

authority of a special act of the legislature, will, as a rule, be invalid if that act is unconstitutional, and should it be sought to uphold the bond by virtue of authority given in some other act of the legislature, to sustain the bond even in the hands of a *bona fide* purchaser, it must appear that the terms of the act relied upon have in fact been complied with, and that the bond is in fact legal and valid, as issued in aid of some public and authorized purpose.[1] Bonds of a county in Kansas had been properly issued under authority in aid of a railroad company, and afterwards, under authority of legislative act, the county took up these bonds and issued funding bonds in exchange for them, changes beneficial to the county being made in their terms. A portion of the county had in the meantime been detached from the county. The Supreme Court held that though the funding bonds were technically both authorized and issued after the detachment of this portion of its territory, yet, within the spirit of the law, and legally, the funding bonds were a charge against the detached territory the same as the railroad aid bonds for which they were exchanged had been.[2] The Supreme Court of Illinois refused a *mandamus* to compel a county to issue $20,000 in bonds of the county to a railroad company for $20,000 in its shares of stock to be immediately returned to the company upon payment of two dollars on its part, according to the terms upon which this subscription of the county was entered upon the subscription books of the company, upon the ground that such an agreement to sell and transfer that amount of stock for two dollars was fraud *per se* and the court could not recognize or enforce it as valid or obligatory.[3] A county subscribing to the stock of, and issuing bonds in payment to, a railroad corporation, existing at the time as a matter of fact, the question whether the corporation had then a legal existence cannot be raised in an action on the bonds, this being a question between the railroad and the state.[4] It is no defense against a third person who is an

[1] County Court of Macoupin County *v.* People ex rel., etc., (1871) 58 Ill. 191.

[2] Dallas County *v.* Huidekoper, (1880) 14 Sup. Ct. Rep. 1190, following Smith *v.* County of Clark, 54 Mo. 59. The same question is considered in County of Macon *v.* Shores, 97 U. S. 272, 276.

innocent purchaser for value that there was fraud in the issue of bonds given by a county in aid of a railroad.[1] Even when allowable such defense must be set up before judgment; it cannot be interposed to an action to enforce the judgment.[2] The fact that a railroad company, which has received the bonds of a county issued to it under a law authorizing the same, but requiring that the railroad company shall not sell them for less than par, does sell such bonds below par will not affect the right of the holder of the bonds to recover principal and interest at par.[3]

§ 441. Elections to authorize aid bonds — how called — how questions must be submitted to voters — how result determined, etc. — The particular county authorities upon whom is conferred the power to call an election upon the question of subscriptions to the stock of a railroad company, must call the election. If called by any other authority their action will be simply void for want of power.[4] Where an election on the question of a subscription by a county to the stock of a railroad company, and issuance of bonds in payment of the subscription, is called by the wrong public authority, the bonds issued under such an election, though issued by the proper public authority, would be absolutely void. The fact that a majority of the votes at such an election may have been in favor of the subscription would not relieve the election and subsequent issue of the bonds from their illegality.[5] Where the power of counties to contract with a railway corporation to subscribe to its capital stock is dependent upon its being authorized by a vote of the people, the county authorities cannot hold out any offer to the railway corporation prior to a vote upon which the corporation has a right to rely.[6] As a rule, where there is fraud and illegality in the election, the officers of the municipal corporation have no power to validate such election by acts and admissions.[1] In an Indiana case the county attempted to evade its liability upon the bonds issued by the county authorities upon the ground that informalities had occurred in giving the notice and in conducting the election to determine whether the county would, or not, authorize a subscription to the stock of the railroad company, contending that these irregularities rendered the bonds and coupons void. The Supreme Court held the county liable upon the bonds and coupons.[2] Where the act authorizing a subscription of this kind requires the name of the railroad company to be specified as the recipient of the aid, a vote to aid in the construction of a railroad along a certain route would give no authority to the commissioners of a county to subscribe to stock of, or issue bonds to, any corporation.[3] The modus of procuring a subscription by a county to the stock of a railroad corporation, payable in the bonds of the county, under the provisions of the Alabama statute authorizing such subscriptions, was as follows: "The said railroad companies, by their *president and a majority of their directors*, may, in writing, propose to any such county that it shall subscribe for and take an amount of their capital stock, to be named in said proposal, at a certain price per share, and pay for the same in the

[1] Muscatine *v.* Mississippi & M. R. R. Co., 1 Dill. 536.

[2] Ibid.

[3] Richardson *v.* Lawrence County, (1864) 14 Sup. Ct. Rep. 1157. See, also, Woods *v.* Lawrence County, 1 Black, 386.

[4] Gaddis *v.* Richland County, 92 Ill. 119; Jacksonville, N. W. & S. E. R. R. Co. *v.* Virden, 104 Ill. 339. As to steps preliminary to an election, see People *v.* Town of Oldtown, 88 Ill. 202; Fulton County *v.* Mississippi & Wabash R. R. Co., 21 Ill. 338; Lippincott *v.* Town of Pana, 92 Ill. 24.

[5] Supervisors of Marshall County *v* Cook, (1865) 38 Ill. 44. In which case the board of supervisors were the proper authorities to order the election under the law as it then stood, and the election was ordered by the County Court, and the bonds were issued by the board of supervisors.

[6] People *v.* Cass County, 77 Ill. 438.

[1] People *v.* Logan County, 63 Ill. 374; People *v.* Cline, 63 Ill. 394.

[2] Johnson *v.* County of Stark, (1860) 24 Ill. 75. The court said: "In the case of Prettyman *v.* Tazewell County, 19 Ill. 406, it was held that if such irregularities had occurred it was necessary, for the purpose of preventing the officers from proceeding to make the subscription and to issue the bonds, that steps must be promptly taken by an appropriate remedy to contest the election and restrain them from proceeding; and that we must not inquire after any considerable delay whether fraudulent means had been resorted to for the purpose of procuring a favorable result to the election of subscription. It would be manifestly against every principle of justice to permit the taxpayers and citizens of a county, through their officers, to procure money, labor or materials upon bonds of the county, issued on an affirmative vote of the citizens at an election held in a case authorized by the law to escape all liability because of some slight informality in conducting the election which was, or at least might have been, readily known to any citizen of the county before the bonds were issued. Counties have no right to procure all the benefits of an act which they are authorized to perform, recognized and voted upon by them as legal, and then escape liability any more than have private individuals. They must respond to their legal engagements to the same extent as individuals."

[3] Gulf Railroad Co. *v.* Miami County, 12 Kans. 230; Lewis *v.* Bourbon County, 12 Kans. 186.

bonds of the county, as shall be set forth in said proposal." "That upon the application of the *president and directors of any of the railroad companies of Alabama*, to the Commissioners' Court of any county of the same, submitting proposals for a county subscription to the capital stock of said railroad company, the Commissioners' Court of said county in which application is made, is hereby authorized and required to order an election within sixty days after the meeting of said court, to submit the proposition of said railroad company to the qualified electors of said county, for their acceptance or rejection." In a case where a proposal was made for a subscription by the corporators of a railroad company, in which the signers were styled, one as president and the others as directors, but there had been no election of officers by the stockholders of the corporation, as required by the law governing such corporations, and the county commissioners had ordered an election and declared the vote in favor of the subscription by the county, and were about to issue county bonds to the railroad corporation in conformity with the vote, the Supreme Court held that such proposal by the corporators was not such as the statute contemplated and provided, and that the election ordered and held was void, and that there was no power in the county commissioners either to make the subscription or to issue the bonds of the county in payment of such subscription, and reversed the decree of the chancellor dismissing the bill praying an injunction and remanding the same for further proceedings.[1] They also held that the proceedings for the subscription, vote and bonds in this case were not in substantial compliance with the act authorizing subscriptions by counties, and, therefore, the later statute, proposing to legalize subscriptions, etc., of this kind on the part of counties, had no curative effect in this case.[2] It is not necessary, under the General Railroad Law of Missouri, that the

[1] Trammell *v.* Pennington, (1871) 45 Ala. 673.

[2] Ibid. Rules as to a majority of voters under statutes authorizing aid to railroad corporations. McDowell *v.* Rutherford Ry. Construction Co., 96 N. C. 514; s. c., 2 S. E. Rep. 351; Kentucky Union Ry. Co. *v.* County of Bourbon, 85 Ky. 98; s. c., 2 S. W. Rep. 687; Wood *v.* Commissioners of Oxford, 97 N. C. 227; s. c., 2 S. E. Rep. 653. Illustrations of notices of elections for a vote of aid to railroads held to satisfy the requirements of the statutes. Yarish *v.* Cedar Rapids, I. F. & N. W. Ry. Co., 72 Iowa, 556; s. c., 34 N. W. Rep. 417, following Burges *v.* Mabin, 27 N. W. Rep. 464; Bartemeyer *v.* Rohlfs, 71 Iowa, 582; s. c., 32 N. W. Rep. 673. An election for an issue of bonds in place of other aid bonds that had matured, held not necessary under the constitutional provisions of North Carolina in Blanton *v.* Board of County Commissioners, 101 N. C. 532; s. c., 8 S. E. Rep. 163.

order submitting to the voters of the county a proposition to subscribe to stock in a railroad company should specify the name of the corporation, where the proposition describes the proposed route of the road with the requisite certainty.[1] An election upon the question of granting aid to railroad corporations may be contested, and its validity determined in a proceeding directly for that purpose, notwithstanding the facts that the county commissioners may have subscribed for shares of the capital stock of the railroad corporations, and the latter may have made contracts based upon such subscription.[2] Where a charter for a railroad company provided that the County Court of a county in Ken-

[1] Ninth National Bank *v.* Knox County, 37 Fed. Rep. 75. See, also, Kentucky Union Ry. Co. *v.* County of Bourbon, 85 Ky. 98; MacKenzie *v.* Wooley, 39 La. Ann. 944; Young *v.* Railroad Co., 75 Iowa, 140; State *v.* Harris, 96 Mo. 29; Onstott *v.* People, 123 Ill. 439. In Nelson *v.* Haywood County, 3 Pickle, 781; s. c., 11 S. W. Rep. 885, an election ordered by the County Court on the question of "bonds" or "no bonds," and the return of the officer holding the election showed that this was the proposition actually voted on, was held to be in accordance with the statute of Tennessee, though it might be inferred from the officer's return that the election was on bonds to be given in subscription for the stock. Where, under a statute of Iowa, notice by publication in a newspaper of an election for a tax in aid of a railroad corporation was held not to be required. Johnson *v.* Kessler, 76 Iowa, 411; s. c., 41 N. W. Rep. 57. In Christian County Court *v.* Smith, (Ky.) 12 S. W. Rep. 134, an election at which the question of subscribing to the capital stock of two different railroad companies was submitted, was held to be null and void under the statute of Kentucky prohibiting more than one question of taxation to be submitted to the voters at one election.

[2] Goforth *v.* Rutherford Ry. Construction Co., 96 N. C. 535; s. c., 2 S. E. Rep. 361. That taxpayers of a county may maintain an action in the proper court to declare a subscription on the part of a county to stock of a railroad corporation void, and to enjoin the collection of a tax to pay it on the ground of the illegality of the election authorizing the subscription, see Kentucky Union Ry. Co. *v.* County of Bourbon, 85 Ky. 98; s. c., 2 S. W. Rep. 687. In State ex rel. *v.* Nemaha County, 10 Kans. 569, where there had been an election authorizing a subscription to the stock of a railroad company, but before the subscription had been actually made under authority granted in the general law in force at the time of the election the company had consolidated with another, the authority to make the subscription was held to have been terminated and that the county was not bound by an attempted subscription to the stock of the consolidated company by the commissioners, their action being *ultra vires*. Bonds of a county in Tennessee containing a recital that they were issued under the act authorizing them, having been delivered to a railroad company and interest paid on them for fifteen years, the Supreme

tucky might submit the question whether the court should subscribe to the capital stock of the railroad company on behalf of the county, either absolutely or upon conditions, the Court of Appeals held that the County Court was the judge of the character of the proposition it would present, and had discretionary power to submit or not the question to the voters of the county, who had the ultimate power of adoption or rejection.[1] But if, after the County Court had prepared the conditions of the contemplated subscription, and submitted them to the people, and the vote taken had resulted in favor of the adoption of the conditions, the County Court could not revoke its action and order a second vote, as it would be assuming legislative functions for it so to do.[2] And where the terms of the order of the County Court submitting the proposition provided that if the vote was favorable the county judge should, upon proof that the conditions precedent had been complied with, order the clerk to make the subscription, the action of the county judge would be conclusive, if he had not acted fraudulently or in bad faith.[3] A county in Kentucky was authorized by statute to subscribe to the stock of a railroad company upon condition that the holders of real estate in the county should, by a majority, vote for such subscription, and the question was submitted by the County Court to all the voters of the county. The Court of Appeals held this submission to have been not such as the statute required, and a levy of tax to pay such subscription to be invalid.[4] The statute in this case also provided "that before subscription should be made and the tax levied, the question of levying the tax should be submitted to the voters of the county, and if a majority of the votes cast should be in favor of the tax it should be levied." The Court of Appeals held that the submission of the question of making a subscription to the stock of railroad company alone, without submitting the question of levying the tax, did not authorize the levying of the tax.[5] The Supreme Court of Alabama held that

Court of that state held that the county could not set up an irregularity in the election as against an innocent purchaser of the bonds. Nelson *v.* Haywood County, 3 Pickle, 781; s. c., 11 S. W. Rep. 885.

[1] Madison County Court *v.* Richmond, Irvine & T. F. R. R. Co., 80 Ky. 16.

[2] Ibid.

[3] Ibid.

[4] Bullock *v.* Curry, 2 Metc. (Ky.) 174.

[5] Ibid. Validating subscriptions by legislative action. Shelby County Ct. *v.* C. & O. R. R. Co., 8 Bush (Ky.), 218. Power of the legislature after a vote is taken. C. & O. R. R. Co. *v.* Barren County Ct., 10 Bush (Ky.), 610.

a writ of *mandamus* should be granted to enforce the subscription of a county to stock in a railroad company, and the issuance of the bonds of the county in payment of the subscription to the stock, which had been voted in pursuance of the act of Alabama, authorizing such subscriptions, by the people of counties, where the Court of County Commissioners refused to comply with the requirements of the act, upon the ground that the act was void for want of conformity to the Constitution of the state.[1] The charter of an Illinois railroad company authorized certain counties through which the road was to pass to subscribe to stock therein, making it the duty of the board of supervisors of the several counties, upon the application in writing of the board of directors of the road, to order an election in the counties upon the question of making the subscription, etc. It also provided "that, should the voters of such county refuse to vote such subscription, the board of directors, by a petition signed by at least two hundred legal voters of such county, presented to the board of supervisors thereof, may require them to submit the same proposition to the voters of such county at any subsequent general or county election." The board of directors acted under the provisions of the charter, and applied to the county authorities for a subscription to a certain amount; an election was held and the county refused to vote the subscription. The board of directors then presented a petition with the requisite number of voters, as required by the last provision, requesting a submission of the same question at the next election. The Supreme Court held that the board of supervisors were not warranted in refusing the petition on the ground that the president of the railway company having alone acted in the matter, therefore, the petition had not been regularly presented, it appearing that his action was authorized by a resolution of the board of directors. And, it having also been objected by the supervisors that no evidence existed of the fact of the genuineness of the petition, and the board of directors of the company, therefore, having offered to make the necessary proof thereof, which was refused, the court held that,

[1] Ex parte Selma & Gulf R. R. Co., (1871) 45 Ala. 696. As to the power of the legislature in such cases, see Stein *v.* Mayor of Mobile, 24 Ala. 591; Stein *v.* Mayor of Mobile, 17 Ala. 234. See, also, Von Hoffman *v.* City of Quincy, 4 Wall. 535; Mitchell *v.* Burlington, 4 Wall. 270, 274; Thompson *v.* Lee County, 3 Wall. 330; Meyer *v.* City of Muscatine, 1 Wall. 385; Gelpcke *v.* City of Dubuque, 1 Wall. 202.

while the board of supervisors of the county might have acted upon it as genuine, without proof, or might have required proof that the petitioners were legal voters of the county; yet, by their refusal to hear such proof they would be regarded as having waived it. The court also construed the provisions of the charter upon this subject, and held that, when the request was made as directed, the board of supervisors were bound to submit the proposition to a vote of the county; that they had no discretion in the matter nor as to the amount so asked to be subscribed, the power to fix the amount having been conferred upon the directors of the company; that the board of supervisors had the power only in case the subscription was voted to withhold it so long as any two of the counties named in the act should fail or refuse to vote for such subscription, as also the power to fix the interest upon the bonds issued, and the time of their payment within the limits fixed by the act.[1] Should a county pay interest on bonds issued by it in payment of subscription to the stock of a railroad company, and vote on the stock it may have received for the bonds, and the bonds have passed into the hands of innocent purchasers without notice, the county will not be allowed to urge any mere irregularities in the election on the question of issuing the bonds, so as to defeat a recovery upon the bonds or the coupons thereto attached.[2] An act authorizing the subscription to stock of, and issue of bonds to, a railroad company, provided for bonds "drawing interest at the rate of ten per cent per annum." The question submitted to the voters at the election was as to subscribing for stock and issuing bonds therefor, to bear not to exceed ten per cent interest. The action of the voters in voting in favor of this proposition was construed as an assent to the issue of bonds bearing the rate prescribed by the act.[3] It would be a good defense on the part of a county to an application for *mandamus* to compel the issuing of bonds to a railroad company that the majority of the votes at the election held to authorize it was made up of illegal votes; that a majority of the legal votes cast at the election was against the subscription, and that the company had notice, before entering into liabilities, of the character of the vote.[4]

[1] People ex rel. Prettyman *v.* Board of Supervisors of Logan County, (1867) 45 Ill. 162.

[2] Board of Supervisors of Mercer County *v.* Hubbard, (1867) 45 Ill. 139.

[3] People *v.* Board of Supervisors of Ford County, (1872) 63 Ill. 142.

[4] People *v.* Board of Supervisors of Logan County, 63 Ill. 374. When elections authorizing aid bonds by a county under Kentucky statutes were held to have been void. Christian County Court *v.* Smith, (Ky.) 13 S. W. Rep. 276. An election for such bonds under Kansas laws held void because of want of a sufficient petition. Chicago, K. & W. R. R. Co. *v.* Comrs., 43 Kans. 760; s. c., 23 Pac. Rep. 1064. The submission of a proposition to the voters which was held not to invalidate the bonds in the hands of innocent purchasers. Williams *v.* People, (Ill.) 24 N. E. Rep. 647.

This was an action in the federal court by a holder of overdue interest coupons, upon municipal bonds issued by a county in Mississippi in payment of a subscription by the county to the capital stock of a railroad company. The Constitution of that state provides that: "The legislature shall not authorize any county, city or town to become a stockholder in, or to lend its credit to, any company, association or corporation, unless two-thirds of the qualified voters of such county, city or town, at a special election or regular election to be held therein, shall assent thereto." It was claimed before the Supreme Court of the United States, on behalf of the county, that the qualified voters referred to in the Constitution and the charter of the railroad company were those who had been determined by the registrars to have the requisite qualifications of electors, and who have been enrolled by them as such, and that it required a vote of two-thirds of the whole number enrolled as qualified voters, and not merely two-thirds of such actually voting at an election for that purpose. The question presented, therefore, by this claim to the Supreme Court, under the plea of the county, that "the board of supervisors fraudulently and illegally issued and delivered the bonds and coupons," had reference, as viewed by the court, merely to the bonds being issued without the alleged requisite assent of two-thirds of the registered vote. It was held that the assent of two-thirds of the qualified voters at an election lawfully held for that purpose, to a proposed issue of municipal bonds, intended by the Constitution of the state, meant two-thirds of the qualified voters present and voting at such election in its favor, as determined by the official return of the result; that the words "qualified voters," as used in the Constitution, must be taken to mean not those qualified and entitled to vote, but those qualified and actually voting.[1] It has been held in the federal court that, under the provision of the Constitution of Mississippi, which declares that the legisla-

[1] Carroll County *v.* Smith, (1884) 111 U. S. 556, following St. Joseph Township *v.* Rogers, 16 Wall. 644, and County of Cass *v.* Johnston, 95 U. S. 360, and declining to accept the rule declared in Hawkins *v.* Carroll County, 50 Miss. 735.

ture shall not authorize any county, city or town to aid any corporation, unless two-thirds of the qualified voters of such municipality shall assent thereto at a special election, railroad aid bonds were not invalidated in the hands of innocent purchasers by the fact that less than such majority voted for them, where more than two-thirds of the votes cast were in favor of issuing the bonds.[1] The *gravamen* of a bill filed by the supervisors of a county in Mississippi to enjoin the further payment of certain bonds issued by the county in aid of a railroad company, is thus stated in the opinion of the Supreme Court of that state, rendered by Woods, Ch. J.: "The *gravamen* of complainant's bill is that these bonds are invalid, because the subscription to the capital stock of said railroad company and the issuing of the bonds were not made after two-thirds of the qualified voters had signified their assent thereto, as required by the Constitution of the state and the act of the legislature passed in that behalf. The bill does not deny that the respondents are *bona fide* holders of the bonds and without notice of the alleged irregularity complained of as rendering the bonds invalid; but the ground relied upon is, that the respondents, though purchasers without notice in the usual acceptation of that term, are yet not to be protected, for the reason that their innocence in this case is only and really their ignorance of the essential facts, as is alleged, that less than two-thirds of the qualified voters of the county assented to the subscription to the capital stock of said railroad company, and that this essential fact was and is a matter of public record equally accessible to all persons, being contained in the registration lists of the voters of the county. In other words, this is the underlying proposition on which the contention of the bill of complaint rests, namely, that though an election was conducted under the forms and in accordance with the provisions of the act of the legislature; though the board of supervisors examined the returns made to it by the officers who managed the election, and, as the result of such examination, determined that two-thirds of the qualified voters had cast their ballots in favor of such subscription, nevertheless the bonds are invalid even in the hands of *bona fide* holders, for the reason that the board of supervisors had no authority or power to ascertain, determine and declare

[1] Madison County *v.* Priestly, Treasurer, (1890) 42 Fed. Rep. 817, following Carroll Co. *v.* Smith, 111 U. S. 556; s. c., 4 Sup. Ct. Rep. 539.

the essential fact that the requisite two-thirds of the qualified voters had assented to the subscription, this essential fact being referable to and determinable alone by a fixed standard, to wit, the registration lists of the voters of the county." The court held that whether the required vote had been cast to authorize these bonds, was a question determinable by the board of commissioners of the county, and was conclusive; that the county was estopped in this action by *bona fide* holders of the bonds to claim that they were invalid because they had not been authorized by a proper vote at the election held with reference to their issue.[1]

[1] Board of Supervisors of Madison County *v.* Brown, (1890) 67 Miss. 684. The court summed up its conclusions as follows: "Beginning with Knox County *v.* Aspinwall, 21 How. 539, and running through a long line of cases, ending with Township of Bernards *v.* Morrison, 133 U. S. 523, in which Mr. Justice Brewer delivered the opinion of the court, the Supreme Court of the United States has uniformly held that the ascertainment and determination of the essential fact of the assents of the required number of voters requisite to authorize subscriptions for stock and the issue of bonds, belong to the tribunal to which was confided the control of the matter. In the last-named case Mr. Justice Brewer observes: 'While it is true that the act does not in terms say that these commissioners are to decide that all preliminary conditions have been complied with, yet such express direction and authority is seldom found in acts providing for the issuing of bonds. It is enough that full control in the matter is given to the officers named.' And this conducts us to the conclusion that there is no foundation upon which to plant the contention of [the county's] counsel, that the Supreme Court of the United States has either overruled or modified any former decision, made in that form, along the line of kindred adjudication. There can be no room for skepticism as to the true doctrine in this state. In Vicksburg *v.* Lombard, 51 Miss. 111, it was said that 'if the constituted authorities of the city put the bonds on the market, or deliver them to the railroad company for sale on the assertion that the proper vote was given, the city ought to be estopped from setting up against the *bona fide* holder the plea that the assertion is untrue.' In Cutler *v.* Madison County, 56 Miss. 115, Chief Justice Simrall, speaking for the court, said: 'The statute under which these bonds were executed made it the duty of the board of supervisors to canvass the votes, and declare the result of the election. Their decision is conclusive on the county, in a controversy between it and a *bona fide* purchaser of the bonds.' In Madison County *v.* Paxton, 57 Miss. 701, Chief Justice George, in speaking of a part of the series of bonds involved in the present litigation, said: 'It will be noticed that there is no attempt to shelter Paxton's purchase under the rights which a purchaser from the company may have had, in case his purchase was *bona fide*. The overwhelming force of the two cases last cited as authority in the case at bar, will be acknowledged by any one when it is remembered that the bonds whose validity was there assailed, and in the case before us, are parts of the same issue.'"

The bonds involved here were county bonds, issued by a county in Missouri, in payment of a subscription to the stock of a railroad, which was to run through that county. There were a number of questions considered and adjudicated by the United States Supreme Court, bearing upon the election ordered and held in the county to authorize such bonds. The order for the election directed that notice thereof "be given, through the [local newspaper] for five weeks, and by printed handbills publicly exposed throughout the county." It also named the second Monday in March as the day for the election. No evidence was offered on the trial of any printed handbills, or of the publication of the notice in the newspaper. It was insisted that, in the absence of evidence, there could be no presumption that notice was given either by handbills or in the newspaper. Another insistment was that between the date of the order, February sixth, and the date of the election, March twelfth, it was not possible to make the prescribed publication because, excluding the day of the order and including the day of the election, there would be only thirty-four days, or one day lacking the five full weeks. The statutes of Missouri at that time in force provided, in accordance with the general rule in respect to such matters, that "the time within which an act is to be done shall be computed by excluding the first day and including the last."[1] Mr. Justice BREWER, speaking for the court, said, upon the objections: "But the notice required for this election was not prescribed by statute. It was fixed by order of the County Court, and there being but thirty-four days between the day of the order and that named for the election, it must be presumed that what was intended was not a publication for five full weeks of seven days each, but a publication in each of the five weeks, which could easily be made in the thirty-four days. It cannot be supposed that the County Court directed a notice which it was impossible to give, or that it was putting the people to the annoyance and the county to the expense of an election which was necessarily void by reason of an inability to comply with the terms of the order. The order must be construed so as to make possible a valid election, and that is accomplished by construing it, and in a reasonable way, as requiring advertisement in five successive weekly issues of the paper named.[2] The

[1] Gen. Stat. Mo. 1866, p. 84, § 6.

[2] Knox County *v.* Ninth National Bank, (1893) 147 U. S. 91, 96, 97.

provisions of the Constitution of Missouri adopted in 1865, that "the general assembly shall not authorize any county, city or town to become a stockholder in, or to loan its credit to, any company, association or corporation, unless two-thirds of the qualified voters of such county, city or town, at a regular or special election to be held therein, shall assent thereto," was invoked in behalf of the county issuing these bonds in aid of the Missouri and Mississippi Railroad Company resisting a recovery. The Supreme Court held that the validity of the bonds was not affected by that provision of the Constitution.[1] As to the objection made to the use of the words "bonus" in the submission of a proposition to the voters of a county in Illinois whether or not

[1] Knox County *v.* Ninth National Bank (1893), 147 U. S. 91. The court said: "At the October term, 1867, of the Supreme Court of Missouri the case of State *v.* Macon County Court, 41 Mo. 453, was decided, in which it was held that the Constitution had no retroactive effect upon statutes passed before its adoption, and that, therefore, under the Missouri and Mississippi Railroad Company Act, passed February 20, 1865, a few months before the adoption of the Constitution, there was power in the county authorities to subscribe without the assent of the voters. It may well be believed, as asserted by counsel for defendant in error, that, until that decision was announced, the understanding that the prohibition in the Constitution superseded all unexecuted authority given by prior charters was so general that no County Court would have dared to subscribe stock and issue bonds without the assent of two-thirds of the qualified voters. The subscription was made, some of the bonds issued, as well as the vote held, before the decision in the Macon County case, and it is difficult to believe that the County Court did not issue these bonds in reliance upon the authority given them by the vote of the people, in pursuance of the general laws of the state, although referring on the face of the bonds to the Missouri and Mississippi Railroad Company Act, which specially authorized the company to receive, and the counties through which it ran to make, subscriptions. It is very likely that the County Court had in mind the special act creating the Missouri and Mississippi Railroad Company, as well as the general law, and the vote of the people under it, and that it meant to exercise all the authority conferred by both. It is enough for this case that the vote of the people authorizing the issue of bonds was given, and that the County Court acted in reliance thereon, for, by assent, through their vote, to such issue of bonds, the people, in the way prescribed by the statutes of the state, in effect consented that the levy beyond the meagre one provided for by the Missouri and Mississippi Railroad Company Act might be resorted to for the payment of these bonds." As to the validity of an election authorizing county aid bonds to be issued to a railroad company, though no particular corporation as the recipient of the aid be designated, and that it is sufficient simply to designate the route, see Knox County *v.* Ninth National Bank, (1893) 147 U. S. 91; Commissioners *v.* Thayer, 94 U. S. 631; Scipio *v.* Wright, 101 U. S. 665.

its swamp lands should be appropriated in aid of the construction of a certain railroad run through the county, the Supreme Court of the United States said, in this case: "The objection to the word 'bonus' in the proposition submitted to the voters of Wayne county is not valid. This submission, in connection with the general subject of a failure to comply with the requisites prescribed by the statute, has been already discussed. Upon its individual merits we are also of the opinion that the objection is not valid. It is a verbal criticism merely — an objection to the words and not to the substance of the submission. A proposition was submitted to the voters, of which the affirmative was in these words: 'For appropriating the swamp lands of Wayne as a bonus to any company, for building a railroad through said county.' It is said that the word 'bonus' condemns the submission; that this means a gratuity, a voluntary donation, a gift, and that a town or county cannot, although it have the direct authority of the legislature, give away its property. When this question is properly before us it will be disposed of. It does not, however, arise in this case. In the first place, if it be assumed that the word is correctly defined as a gift or gratuity, that meaning is controlled and limited by the connection in which it is here used, to wit, that in consideration of it the company receiving the lands will undertake to build a railway through the county. It is not simply a *bonus*, but a bonus to any company who shall undertake the great task of building a railroad through the county, a task which it is loudly complained has not yet been performed by any one."[1] The bonds, in a case before the United States Supreme Court, stated that they were issued under the statute of Nebraska relating to the subject, to aid the company in improving the water power of the river for the purpose of propelling public grist mills, "and other works of public improvement of a public nature" in the precinct. It was objected that the latter part of the statement was indefinite, and the other works to be aided or improved, or propelled, should have been decided or identified, so that it might be seen they were works of internal improvement, within the Nebraska statute, and also because the proposition voted on must, in order to be a lawful one, have stated what the specific "other works" were. To this the court said: "It is a sufficient answer to this question to say that the petition states, and

[1] Kenicott *v.* Supervisors, (1872) 16 Wall. 452, 470, 471.

the demurrer admits, that the only work of internal improvement of a public nature for which the bonds were issued to the company, was the improvement of the water power of the Elkorn river for the purpose of propelling public grist mills in the precinct; that the improving of such water power for that purpose rendered it available and useful for propelling other works of internal improvement of a public nature, which were, or thereafter might be, constructed and located on that river in that precinct; that the improvement of the water power of that river, to aid which the bonds were issued and negotiated, consisted in constructing a canal for water power purposes in the precinct; and that the bonds and their attached coupons were issued and negotiated under and by virtue of a majority vote of the qualified voters of the precinct, and in pursuance of the act. Thus, there is a distinct statement, as well as an admission, that no work of internal improvement was covered by the vote or the issue of the bonds, other than the one of improving such water power for the purpose of propelling public grist mills in the precinct. The statement in the bonds in regard to propelling other works of an internal improvement of a public nature in the precinct, is explained by the allegation in the petition that the improving of the water power for the purpose stated rendered it available to propel other works of internal improvement of a public nature, then existing or which might be constructed on the river within the bounds of the precinct. But this was an incidental result, and aside from the only work in aid of which, or as notified to, or known by, the plaintiff, at the time of the sale and delivery of the bonds to him."[1]

[1] Blair *v.* Cuming County, (1884) 111 U. S. 363, 368, 369. The following cases, referring to bonds issued in aid of "public improvements" under the Nebraska statutes and the power to issue them, were reviewed by the court: Osborne *v.* County of Adams, 106 U. S. 181; Traver *v.* Merrick County, 14 Neb. 327; Osborne *v.* Adams County, 109 U. S. 1; Union Pacific Railroad *v.* Commissioners, 4 Neb. 450; United States *v.* Dodge County, 110 U. S. 156; State *v.* Thorne, 9 Neb. 458; Dawson County *v.* McNamar, 10 Neb. 276; Nosser *v.* Seeley, 10 Neb. 460; Seeley *v.* Bridges, 13 Neb. 547; Township of Burlington *v.* Beasley, 94 U. S. 310. As to enterprises which are so far of a public nature that private property may be appropriated to carry them on, they cited: Boston & Roxbury Mill Corp. *v.* Newman, 12 Pick. 467; Commonwealth *v.* Essex Company, 13 Gray, 239; Lowell *v.* Boston, 111 Mass. 454; Scudder *v.* Trenton Delaware Falls Co., 1 Saxt. (N. J. Ch.) 694; Beekman *v.* Saratoga & Schenectady R. R. Co., 3 Paige, 45.

§ 442. Conditions to subscriptions — the right to prescribe, etc.— Though the law authorizing aid by a county, by way of subscription to stock of, and issue of bonds to, a railroad company may be silent as to conditions of subscription, the municipality voting aid may lawfully impose conditions upon which the subscription will be made, and, until a compliance with such conditions, the county cannot be compelled to issue and deliver the bonds by mandamus.[1] Where conditions have been imposed by the vote of the people upon such a subscription, the county authorities cannot delegate to others the determination of the question whether or not the conditions have been complied with. They must determine that fact themselves, as the authorized agents of the people.[2] Where the subscription and issue of bonds is subject to conditions before the bonds can be delivered, the county authorities would have no lawful power to issue the bonds in blank as to date, and place them in the hands of trustees, to be dated and delivered when the conditions may be performed.[3] A county having submitted the question of taking stock in a railroad company subject to conditions, the conditions may be removed by a second submission of the entire question to the electors.[4] Where a vote of a county in favor of bonds in aid of a railroad company in Illinois had been coupled with conditions that the road should be located at a designated place, and that the subscription should not be paid until the road was constructed, it was held that this did not amount to a contract to subscribe when the conditions were performed; also, that if the county authorities had a discretion to subscribe on a vote without conditions, the annexing of conditions would not deprive them of its exercise.[5] A county having voted aid to a railroad company in building its road by a certain route, without any other conditions, it appearing that the company, by its charter, was not bound to locate its road on that route, but had a large discretion as to the route to be selected, the Illinois Supreme Court held that the board of supervisors had the right to impose conditions as to the permanent location of the road upon the route contemplated, and

[1] People *v.* Glann, 70 Ill. 232; People *v.* Holden, 91 Ill. 446.

[2] Jackson County *v.* Brush, 77 Ill. 59.

[3] Ibid

[4] Board of Supervisors of Mercer County *v.* Hubbard, (1867) 45 Ill. 139.

[5] People *v.* Cass County, 77 Ill. 438. The right to subscribe upon conditions. Land Grant Ry. & Trust Co. *v.* Davis County, 6 Kans. 256.

to make any delivery of the county bonds to depend upon the same, and that the company, by accepting such conditions, was bound by them in respect to its rights under the vote and subscription.[1] It was provided in the statute authorizing an issue of bonds by a municipality in aid of a railroad company that the proceeds be expended in the county, and the specific proposition submitted to the vote of the people was based upon this condition, and the railroad company agreed to expend the money raised in the county. It was held in a federal court that this agreement contemplated the negotiation of the bonds in the regular and ordinary way, and the keeping of the proceeds of the bonds separate from the other assets of the company, and that the proceeds should be expended in the county; that it followed from this that such bonds were not covered by a mortgage of the railway company in favor of which they were issued, covering all its real and personal property then owned or thereafter to be acquired by the company.[2] Though the authority of a board of county commissioners to issue bonds in aid of a railway company upon compliance with certain conditions carries with it no authority to waive the conditions, where there is a failure of the railway company to comply with one of the conditions in some minor respect, and notwithstanding the failure the commissioners acting in good faith issue the bonds, and the failure is a matter which is of public knowledge, a failure by the county to make any objections or take any proceedings, and payment of the interest on the bonds for a series of years, will work a ratification of the action of the commissioners, and the county will thereby be prevented from recovering of the railroad company the bonds or their value.[3] The statute of Kentucky providing that, before county bonds issued in the aid of a railroad are delivered, the president of railroad company shall give bond for the faithful application of

[1] Alley *v.* Adams County, 76 Ill. 101. What was not a compliance with a condition as to the location of a road, and the bonds invalidated thereby, though in the hands of innocent holders, see Parker *v.* Smith, 3 Bradw. (Ill.) 356.

[2] Foote *v.* Mt. Pleasant, 1 McCrary, 101.

[3] Leavenworth, L. & G. Ry. Co. *v.* Douglas Co., 18 Kans. 169. As to prescribing conditions of subscription and the effect upon the railroad company, see People *v.* Holden, 91 Ill. 446. Where the mere fact that a track was laid and trains run over it was not a compliance with the conditions upon which a subscription in aid of a railroad company was voted, as to its substantial completion before the bonds should be issued to it, see Memphis, Kansas & Colorado Ry. Co. *v.* Thompson, 24 Kans. 170.

the proceeds of the bonds to the construction of the road, has been held to have no application where the road had been completed before the bonds were delivered.[1]

§ 443. When authority to subscribe to stock gives no power to issue bonds in payment.— The effect of the statutes of Mississippi as to rendering aid to railroad companies by counties through which the railroads were to be built has been fully considered by the United States Supreme Court in a case coming before it. The court held that, under those statutes, there was no power in the county authorities to issue bonds in payment of subscriptions made by the county to the stock of such roads; that they could subscribe to the stock, but were limited, in payment of the same, to taxation as directed by the terms of the statute.[2]

[1] Breckenridge County *v.* McCracken, (1894) 61 Fed. Rep. 191. Bonds of an Illinois county held invalid for noncompliance with the conditions on which they were voted and issued in aid of a railroad company as to the time the road was to be completed, notwithstanding an extension of time for its completion had been granted by the County Court and board of supervisors, in German Sav. Bank *v.* Franklin County, 128 U. S. 526; s. c., 9 Sup. Ct. Rep. 159. See, also, Onstott *v.* People, 123 Ill. 489; Young *v.* Railroad Co., 75 Iowa, 140; Crane *v.* Railway Co., 74 Iowa, 330; Livingston County *v.* Bank, 128 U. S. 102.

[2] Wells *v.* Supervisors, (1880) 102 U. S. 625. Chief Justice WAITE, in delivering the opinion of the court, referred first to the powers of the county authorities under the statutes of the state generally, and the rulings in Beaman *v.* Leake County, 42 Miss. 247, and Hawkins *v.* Carroll County, 50 Miss. 762, and then said: "Undoubtedly section 17 authorized a subscription to the stock of the railroad company for the county, after a majority of the electors of the county had in the proper way given their consent, and it is possible, if there had been nothing more, that, under the rule of construction stated in Lynde *v.* The County, 16 Wall. 6, the subscription might have been paid in bonds. It seems to us, however, that the provisions of section 18 are such as to exclude any such presumption. By that section the boards of police (supervisors) were authorized to assess and collect a tax on the taxable property or the real property of the county, at their election, 'for the payment of the capital stock subscribed.' No other mode of payment was provided for. This, of itself, when considered in the light of the settled policy of the state, to require the current liabilities of counties to be discharged by current taxation, would seem to indicate an intention not to confer upon the counties the power of funding this kind of liability. But when it is taken in connection with the further provisions of the same section, which authorize the boards of police to direct that the railroad company issue to the taxpayers, in lieu of the county, stock to the amount of the taxes paid, the intention is even more apparent. As stock was to be issued by the county to an amount equal to the taxes paid, it would seem as though it could not have been supposed that before the tax was collected any payment of the subscription was to be made, or any stock issued, that could in any manner interfere with this privilege of the taxpayers. So, too, the company could not be required to issue stock up and to the amount of the subscription. As the taxpayer was to be entitled to stock to the full amount of his payment, it follows that the tax must have been intended to pay the subscription and not bonds. We are not unmindful of the fact that the language of this part of the section is such as to leave it optional with the board to give this direction or not; that it may, nevertheless, be referred to, as we think, to strengthen the presumption arising from the other provisions, that the subscription was not to be paid through taxation, directly or indirectly, until the money to be raised in that way had actually been collected. This statute conferred an extraordinary power on the boards of police. It authorized them to create a new liability for their respective counties, and provided a special way of discharging that liability. The liability and the mode of discharge were provided for in the same statute. This being so, the mode prescribed is exclusive of all others. This case differs materially from Lynde *v.* The County, 16 Wall. 6. There the tax voted was to be levied annually during a period not exceeding ten years, and the amount for each year definitely fixed. As this was done for the purpose of building a court house, the court very properly held the vote implied permission to borrow money to accomplish the object in anticipation of the collection of the tax, which must necessarily be delayed a considerable number of years. Here the tax was to be levied to pay the subscription, that is to say, to pay the company the amount subscribed, when, by the terms of the subscription, that obligation was to be met. As the statute on its face contemplated no delay in raising the money by taxation, no implication of a power to borrow in anticipation of the tax can arise. The subscription might be made, but the money must be raised by taxation to meet it. The railroad company cannot complain; for when it received the subscription it knew, or ought to have known, from what source the money was to come to meet the payment, and it impliedly gave its consent to such delays as were necessarily incident to the mode of collection. The other provisions of the charter as to calls on subscribers to meet their subscriptions were not necessarily applicable to counties. Counties were to pay as they agreed, and when the tax was collected. * * * From the supplemental act it is apparent that the object of the legislature was to raise money by taxation to aid in the construction of the road and require the company to give the taxpayers stock for the money they paid.

A Missouri railroad company had a charter in which it was provided that, "upon the presentation of a petition of the president and directors of said company to the County Court of any county through which said road may be located, praying that a vote may be taken in any strip of country through which it may pass, not to exceed ten miles on either side of said road; that the inhabitants thereof are desirous of taking stock in said road and of voting upon themselves a tax for the payment of the same, it shall be the duty of said County Court to order an election therein,

and shall prescribe the time, place and manner of holding said election; and if a majority of the taxable inhabitants shall determine in favor of the tax, it shall be the duty of said court to levy and collect from them a special tax which shall be kept separate from all other funds and appropriated to no other purposes, and as fast as collected shall cause the same to be paid to the treasurer of said company." An election was held in a strip of a county properly called by the County Court, and the vote was in favor of the subscription. The County Court subscribed to the stock of the company in obedience to the will of the people, and issued bonds in payment of the subscription. In an action upon the coupons of some of these bonds the Supreme Court held the bonds to be void, notwithstanding the suit was by a *bona fide* holder of the bonds, for lack of authority in the County Court to issue the bonds.[1]

§ 444. When a donation of bonds is authorized.— It was urged, against the validity of a particular statute of Nebraska,

This is entirely inconsistent with any idea of the payment of interest. As the special tax on adjoining lands was large, it was extended over a period of years. This amount was fixed and not left to the discretion of any one. In respect to the country at large the plan adopted was different. There it was left for the people to determine for themselves how much the subscription should be, and for the county and the company to agree when it should be paid. In this way the tax might be extended over a series of years; but as stock was to be issued by the company for all payments made, it could not have been intended to tax beyond the actual amount of the subscription. Consequently, if time was given by the company to make the payment, it must be without interest."

[1] Ogden *v.* County of Daviess, (1883) 102 U. S. 634; followed in Deland *v.* Platte County, (1890) 54 Fed. Rep. 823, in which case this question and others pertinent to it are fully discussed by PHILLIPS, D. J. In Ogden *v.* County of Daviess, *supra*, referring to the provision of the charter above referred to, WAITE, Chief Justice, for the United States Supreme Court, said: "Without doubt [this provision of the charter] authorized the taxable inhabitants of the 'strip of country' designated to vote a tax upon themselves to take stock, and required the County Court to levy and collect such a tax, if voted, and pay over the money as fast as collected to the treasurer of the company; but in this we find no authority for the county to issue bonds in anticipation of the tax. The taxable inhabitants of the strip of country could not themselves make a bond, and all the County Court could do was to collect and pay over the tax voted. The inhabitants were not even organized by themselves, much less made a body politic for any purpose. They could vote the tax if called upon to do so by the County Court, but that was all. The effect of the vote was nothing more than to authorize the County Court to levy, collect and pay over to the treasurer of the company the special tax they had determined upon."

that it authorized the donation of the county bonds to the railroad company, and it was insisted that if even the legislature could empower the county to subscribe to the stock of such a corporation, it could not constitutionally authorize a donation. The United States Supreme Court sustained the constitutionality of the statute.[1] The Nebraska Supreme Court has held that

[1] Railroad Company *v.* County of Otoe, (1872) 16 Wall. 667; cited and applied in Otoe County *v.* Baldwin, (1884) 111 U. S. 1. Mr. Justice STRONG, *arguendo*, said: "There is no solid ground of distinction between a subscription to stock and an appropriation of money or credit. Both are for the purpose of aiding in the construction of the road; both are aimed at the same object, securing a public advantage, obtaining a highway or an avenue to the markets of the country; both may be equally burdensome to the taxpayers of the county. The stock subscribed for may be worthless, and known to be so. That the legislature of the state might have granted aid directly to any railroad company by actual donation of money from the treasury will not be controverted. No one questions that in the absence of some constitutional inhibition the power of a state to appropriate its money, however raised, is limited only by the sense of justice and by the sound discretion of its legislature. If the power to tax be unrestricted, the power to appropriate the taxes is necessarily equally so. Accordingly, nothing has been more common in the state and federal governments than appropriations of public money raised by taxation to objects, in regard to which no legal liability has existed. State legislatures have made donations to numerous purposes whenever, in their judgment, the public well-being required them, and the right to make such gifts has never been seriously questioned. But if a state can directly levy taxes to make donations to improvement companies, or to other objects which, in the judgment of its legislature, it may be well to aid, it will be found difficult to maintain that it may not confer upon its municipal divisions power to do the same thing. Counties, cities and towns exist only for the convenient administration of the government. Such organizations are instruments of the state, created to carry out its will. When they are authorized or directed to levy a tax, or to appropriate its proceeds, the state, through them, is doing indirectly what it might do directly. It is true the burden of the duty may thus rest upon only a single political division, but the legislature has an undoubted power to apportion a public burden among all the taxpayers of the state, or among those of a particular section. In its judgment, those of a single section may reap the principal benefit from a proposed expenditure, as from the construction of a road, a bridge, an almshouse or a hospital. It is not unjust, therefore, that they should alone bear the burden. This subject has been so often discussed, and the principles we have asserted have been so thoroughly indicated, that it seems to be needless to say more, or even to refer at large to the decisions." These few cases were cited: Blanding *v.* Burr, 13 Cal. 343; Town of Guilford *v.* Supervisors of Chenango County, 3 Kern. 149; Stuart *v.* Supervisors, 30 Iowa, 9; Augusta Bank *v.* Augusta, 49 Me. 507. As to the objection that the road

bonds issued by a county as a donation to a railroad company were invalid unless they had indorsed upon them a certificate signed by the secretary and auditor of state, showing that they were issued pursuant to law.[1]

§ 445. When county bonds donated to a railroad company cannot be scaled down.— The holders of some of the bonds of Dixon county, Nebraska, issued as a donation to a railroad company, brought their bill in equity in the United States Circuit Court for that district for relief. The court held that these bonds having been held void in a court of law as in excess of the constitutional limit of indebtedness, equity had no power to scale down the issue to the limit and enforce it against the county, the contract being indivisible and void *in toto*, and there being no executed consideration to support an implied promise.[2] There was an appeal from this judgment rendered by BREWER, Circuit Judge, to the United States Supreme Court, where the judgment was affirmed.[3]

aided lay outside the limits of the county, and outside the state, it was said: "There is nothing in this objection. It was for the legislature to determine whether the object to be aided was one in which the people of the state had an interest, and it is very obvious that the interests of the people of Otoe county may been more involved in the construction of a road giving them a connection with an eastern market than they could be in the construction of any road wholly within the county. But that the objection has no weight may be seen in Gelpcke *v.* Dubuque, 1 Wall. 175, and in Walker *v.* Cincinnati, 21 Ohio St. 14."

[1] State *v.* Roggen, 22 Neb. 118; s. c., 34 N. W. Rep. 108.

[2] Hedges *v.* Dixon County, (1889) 37 Fed. Rep. 304.

[3] Hedges *v.* Dixon County, (1893) 150 U. S. 182. The subject is so fully discussed by the majority of the Supreme Court that the opinion is deemed worthy of reproduction here. Mr. Justice JACKSON, for the majority of the court (HARLAN, J., only dissenting), said: "The bonds in question were made payable to the [railroad company, the donee], or bearer, and were put in circulation by that company with its indorsement thereon, guaranteeing to the holders the payment of the principal and interest of the bonds, according to the tenor thereof, at the place where, and as they became due and payable. The only consideration received by the county in the transaction was the incidental benefit derived from the construction of the railroad — the proceeds of the bonds, when negotiated, being received directly by the railroad company. The theory of the bill is that the bonds are void only to the extent that they exceed ten per cent of the assessed valuation of the property of the county at the time of their issuance, and upon the abatement of that excess the holders are entitled to have the residue thereof — which the county could have lawfully issued — treated as valid because of the incidental benefits derived from the construction of the road which was sought to be secured by the donation of bonds. The complainants, by their bill and exhibit thereto, have presented the same state of facts which were considered in Dixon County *v.* Field, 111 U. S. 83, where the bonds in question were directly involved, and were held by this court to be void because they exceeded in the aggregate the sum of ten per cent of the assessed valuation of the property of the county at the time of their issue. This decision was based upon [that section] of the Constitution of the state of Nebraska which provides as follows: 'No city, county, town, precinct, municipality, or other subdivision of the state, shall ever make donations to any railroad or other work of internal improvement, unless a proposition shall have been first submitted to the qualified electors thereof at an election by authority of law; *Provided*, that such donations of a county, with the donations of such subdivisions, in the aggregate shall not exceed ten per cent of the assessed valuation of such county.' While the complainants concede that the issue of bonds was in excess of what the county was authorized to donate under the provision of the Constitution, and for that reason were invalid at law, they insist that a promise to pay so much thereof as could have been lawfully issued shall be implied and enforced against the county, under the principle applied in Louisiana *v.* Wood, 102 U. S. 294, and in Read *v.* Plattsmouth, 107 U. S. 568. Those cases are clearly distinguishable from the present. In Louisiana *v.* Wood, by the act of the city, the bonds bore a false date which, apparently, made them obligatory and binding; they were sold by the city and purchased by the holders in good faith, and the money paid for them went directly into the city's treasury. This court held that the city was in the market as a borrower and received the money in that character, notwithstanding the transaction assumed the form of a sale of her securities, which, being defectively executed, a suit could not be maintained thereon, and that the holder was entitled to recover the money paid with interest thereon from the time the obligation of the city to pay was denied. In Read *v.* Plattsmouth the bonds were issued by a city for the purpose of raising money wherewith to construct a high school building within her limits. The bonds were sold and the proceeds applied to that purpose. The legislature subsequently legalized the proceedings of the city in the premises, but this act of the legislature was passed after the Constitution of the state went into effect declaring that the 'legislature shall pass no special act conferring corporate powers,' and that 'no bill

§ 446. Bonds of an Illinois county secured by mortgage of its swamp lands.—The charter of an Illinois railroad company provided in one section that "The corporation may borrow such sums of money as they deem advisable, and upon such terms as they may agree, for the carrying out of the objects of this act, and may provide any security therefor they think best by bond and mortgage." In another section it empowered the County Court of the county in which was its starting point to subscribe for its stock, to issue bonds of the county and provide for the payment of the principal and interest thereof by *sale* or *mort-*

gage, one or both, of the *swamp* and *overflowed lands* of such county, and dispose of such bonds for money to pay or in payment of their subscription to said stock, all and each to be upon such time, *terms* and in such *mode* as they may deem best; or they *may make such other disposition* of said swamp and overflowed lands in *aid* of the *construction* and maintenance of said railroad as they *deem best* for the public interest of said county. Another section provided for the submission to the voters of the county propositions looking to the carrying out of the purposes of the charter provisions. There was an additional section in

shall contain more than one subject, which shall be clearly expressed in its title.' A purchaser of the bonds for value, without notice of any infirmity in their issue, brought suit to recover the amount of the coupons then due and unpaid. It was held that as, by force of the transaction, the city was bound to refund the moneys paid it in consideration of its void bonds, and as the act, by confirming them, merely recognizes the existence of that obligation and provides a medium for enforcing it according to the original intention of the parties, no new corporate powers were thereby conferred. In this case, as in Louisiana *v.* Wood, the city got the full pecuniary consideration for the bonds and applied the money for the very purpose for which they were issued; and, upon well-settled principles, if the securities given for the money so obtained proved invalid or defective for any reason, there was a clear legal as well as moral obligation to refund the money which had been so advanced to and received by the city. The circumstances and conditions which gave the holders of the bonds an equitable right in those cases to recover from the municipality the money which the bonds represented do not exist in the case under consideration, where the county received no part of the proceeds of the bonds and no direct money benefit, but merely derived an incidental advantage arising from the construction of the railroad, upon which advantage it would be impossible for the court to place a pecuniary estimate or to say that it would be equal to such portion of the bonds in question as the county could lawfully have issued. Moreover, by the provisions of the Constitution of the state of Nebraska, and by the express terms of the proposition submitted to the vote of the people of Dixon county, the bonds in question were issued *as a donation to the railroad company*, and, being intended as a donation, it cannot properly be said that the purchasers of these bonds from the railroad company paid any consideration therefor to the county so as to raise any equity as against it for the amount represented by the bonds or any part thereof. Any equitable demand which might under the circumstances have existed against the county on the theory of consideration received, was in favor of the railroad company which constructed the railroad, and thereby conferred all the incidental benefits which the county derived from the transaction. If any equitable claim arises in favor of the holders of the bonds, it must be against the railroad company from whom the bonds were purchased and by whom their payment was guaranteed, as that company was the recipient of the legal consideration realized upon the negotiation of the bonds. Again, the Constitution of the state having prescribed the amount which the county might donate to a railroad company, that provision operated as an absolute limitation upon the power of the county to exceed that amount, and it is well settled that no recitals in the bonds or indorsed thereon could estop the county from setting up their invalidity based upon the want of constitutional authority to issue the same. Recitals in bonds issued under legislative authority may estop the municipality from disputing their authority as against a *bona fide* holder for value; but when the municipal bonds are issued in violation of a constitutional provision, no such estoppel can arise by reason of any recitals contained in the bonds. Lake County *v.* Rollins, 130 U. S. 662; Lake County *v.* Graham, 130 U. S. 674; Sutliff *v.* Lake County Commissioners, 147 U. S. 230. But, aside from this view of the subject, the bill proceeds upon the false assumption that the bonds in question were partly valid and partly void, and that the case is brought within the principle announced in Daviess County *v.* Dickinson, 117 U. S. 657. In that case, under authority conferred by statute, the county voted a subscription of two hundred and fifty thousand dollars to a railroad company, which was made, and, by order of the County Court, bonds of the county to that amount were ordered to be sold and disposed of by a committee for the purpose of paying such subscription. The officers of the county, without authority, executed and issued bonds in the amount of three hundred thousand dollars. The bonds, as they were delivered, were separately numbered and entered upon the county register. The court held that the power to issue bonds was limited to two hundred and fifty thousand dollars, and that the bonds issued in excess of that amount were unlawful and void. It was further held that bonds to the amount authorized, which were first issued and delivered, were valid and entitled to payment. In that case there was a clear and well-defined line between the legal and illegal issues which enabled the court to declare invalid such of the bonds as exceeded the amount authorized and to hold that the illegal excess did not vitiate the bonds which were authorized and legally issued. There was no scaling of the entire issue in that case so as to bring it within the limits of the county's authority. The two hundred and fifty thousand dollars, which the court pronounced valid, had been expressly authorized by the county, and the bonds for that amount were readily separated from the fifty thousand dollar excess which had not been authorized. It did not, therefore, involve any investigation on the part of the court to ascertain what the county could lawfully issue, but was

these words: "Any county through which said road *may* run, and *every* county through which *any other railroad may* run with which this road *may be joined*, *connected* or *interested may*, and are hereby *authorized* and *empowered* to, *aid* in the *construction* of the *same*, or of *such other road* with which it may so connect; and for this purpose the provisions [above referred to] *shall extend*, *include* and be *applicable* to *every* such county and *every such* railroad." A county through which this road finally was to run, itself or by connection with another, through its county officials, executed a mortgage of its swamp lands to a

trustee, as a security for bonds of the railroad company which it had resolved to issue to a certain amount upon which to borrow money to construct its road under the authority given in the above provisions of the charter of the railroad company in aid of its construction. In an action to foreclose the mortgage upon these lands in behalf of the bondholders, the county resisted and the bill for foreclosure was dismissed upon the ground that the proofs failed to show that at the date of the mortgage and deed of trust for securing the payment of the bonds there was any line of railroad constructed, or authorized to be constructed, through

merely the identification of the bonds which it intended to issue. Again, the amount of the bonds issued was not based upon the assessed valuation of the property of the county, but was limited to the amount which the people of the county, by an election held, had determined should be issued. There is a radical difference in these respects between that case and the one under consideration. What the county authorized and carried into execution in the present case, both by the vote and by the donation, was one entire transaction, and if it should be so reformed as to curtail the entire issue of bonds to such an amount as was within the constitutional limits of the county to donate, it would be something different from that which was voted by the county and carried into effect by the issue of the bonds. This would involve the making of a different donation from what the county voted and intended to make to the railroad company. It is urged that the vote and the issue of the bonds constituted a contract between the railroad company and the county, and that the bonds issued in pursuance thereof should be scaled, as sought by the bill, to bring the contract within the authority of the county; that as the county intended to make a valid donation such reduction of the amount of the issue which the complainants offer to make should be sanctioned by the court and the residue declared valid. But the difficulty in the way of this suggestion is that, treating the transaction as a contract, it is not within the power of a court of equity to change its terms and provisions. Besides, it is not shown that the county would have voted a different amount from what was issued, or that it intended to issue a less amount. It is too well settled to need citation of authorities that a court of equity, in the absence of fraud, accident or mistake, cannot change the terms of a contract. Again, if a right to the equitable relief sought by the complainants could be worked out on the theory of a contract between the county and the railroad company, it would be necessary to establish that such a contract actually existed and was valid. In the present case, however, the county had no authority to vote the donation. In Peineman *v.* Covington, Columbus & Black Hills Railroad, 7 Neb. 310, where an excessive issue of bonds had been voted by the county in aid of internal improvements, it was held by the Supreme Court of Nebraska that the vote was simply a void act, and conferred no authority on the county officials to issue the bonds of the county, either to the amount voted or for any amount. It was urged in that case, as in this, that even if it should be held that the proposition submitted to the electors was in excess of the amount

the county defendant with which the bonded railroad was joined, connected or interested. Upon appeal, the Supreme Court of the United States held that the section of the charter last referred to, upon the authority of which the mortgage was executed, did not require that the road to be aided should be actually built before a county was authorized to mortgage its lands, but contrariwise, that the aid was intended to be given before the road was built, and that the counties giving the aid were expected to take the ordinary risk of the success of the undertaking in which they embarked their property. Further, they held that where another

authorized to be voted, still, to the extent that the county could have lawfully voted and issued such bonds, they should be treated as constituting a contract between the county and the railroad company, and to that extent be upheld. The Supreme Court of the state declined to accede to this view of the subject, and ruled that 'the proposition submitted to the electors was an entirety and indivisible. It exceeded the statutory limit, and was, therefore, wholly unauthorized. The election was simply a void act, conferring no authority whatever upon the county commissioners to issue bonds of the county in any manner whatever.' Several state decisions have been cited in support of the bill: Johnson *v.* County of Stark, 24 Ill. 75; City of Quincy *v.* Warfield, 25 Ill. 317; Briscoe *v.* Allison, 43 Ill. 291; State *v.* Allen, 43 Ill. 456; Stockdale *v.* Wayland School District, 47 Mich. 226. But they mostly relate to taxes imposed beyond authority, and stand upon a different doctrine from that involved in the present case. We do not, however, deem it necessary to review them, for if they can be construed to support a bill like the one under consideration, we think they are not founded upon correct principles, and are not in harmony with the decisions of this court." Then there was the following comment upon certain of the cases adjudicated in this court: "In Buchanan *v.* Litchfield, 102 U. S. 278, bonds were issued by the city of Litchfield, under authority of a statute of Illinois and an ordinance of the city, for the construction of a system of water works for the use of the municipality. Neither the statute nor the ordinance contained any reference to the provisions of the Constitution prohibiting any county, city, township or school district from becoming indebted in any manner, or for any purpose, to an amount, including exisiting indebtedness, in the aggregate exceeding five per cent of the taxable property therein. The ordinance of the city made no reference to or mention of the indebtedness of the city, although at that time it exceeded the constitutional limit. A *bona fide* holder of the bonds brought suit upon the unpaid coupons thereto attached, and it was held that they were void and could not be recovered. In this case the city was directly benefited by the issue of the bonds, which were negotiated for the sole purpose of erecting a system of public works. The holders of the bonds thereafter sought relief by a bill in equity against the city of Litchfield to enforce the payment of the money loaned, or which the city had received upon the bonds and used in the construction of its public works. The question of their right to recover on the equitable consideration came before this court

company was subsequently chartered to build a road, the course of which ran up to one terminus of the road of the company previously chartered, and thence onward completely through another county adjoining the county in which the former road lay, and the railroad company first chartered undertook the construction of the new road from the terminus above mentioned onwards, completely through the other and adjoining counties, that the authority to construct the connecting road and the entering into a contract for its construction formed a "connection" within the meaning of this provision of the charter.[1]

in Litchfield *v.* Ballou, 114 U. S. 190, and it was held that a provision in a State Constitution that a municipal corporation shall not become indebted in any manner, and for any purpose, to an amount exceeding five per cent of its taxable property therein, forbids implied as well as express liability for the amount or amounts received on bonds issued contrary to such provision, and that a court of equity could not afford relief in such a case either as an express or implied obligation; that the transaction being invalid at law was equally invalid in equity. This conclusion was reached after a free review of the authorities on the question, and the court denied the relief sought. In Ætna Life Insurance Co. *v.* Middleport, 124 U. S. 534, the town of Middleport made an appropriation to a railroad company, to be raised by tax on the property of the town, and bonds of the town for a sum large enough to include interest and discount for which they could be sold and delivered were issued to the railroad company, by whom they were put in circulation. These bonds were declared void, and the insurance company, as a purchaser and holder for value and without notice, of a portion thereof, sought by a proceeding in equity to be subrogated to the rights of the railroad company to enforce payment of the amount of the appropriation voted by the town; but it was held that the purchase of these bonds by the holder was no payment of the appropriation voted by the town, and that the holder was not entitled to claim the benefit of such appropriation, nor that the advantages conferred by the railroad company upon the town inured to the benefit of the holder, or constituted the basis of a consideration on which it could claim to be paid the sum appropriated for the railroad company. The proposition contended for in that case by the complainant was that by its purchase of the bonds, which were supposed to represent the benefit conferred upon the town by the appropriation to the railroad company, it became entitled in equity to claim the payment of the amount represented by the bonds on the basis of the original consideration. This contention was not sustained, and the complainant was denied the equitable relief sought. The principle running through these decisions controls the case under consideration, and clearly establishes that the complainants are not entitled to the relief they seek. The fact that the complainants have no remedy at law, arising from the invalidity of the bonds, confers no jurisdiction upon a court of equity to

[1] Kenicott *v.* Supervisors, (1872) 16 Wall. 452.

§ 447. Precinct aid bonds.— The charter of a railroad company of Kentucky provided that any county through which it might pass, or any magisterial precinct or precincts of such county, might subscribe to its capital stock; that, when any precinct or precincts made such subscription, bonds of the county should be issued, showing on their face the precincts making the subscription, which alone should be bound to pay the bonds. A defined portion of a certain precinct in a county named was excepted from the provisions of the act. The residue of that precinct joined with another precinct of the county in making a subscription, and the bonds issued by the county for these subdivisions were the ones involved in this action. The United States Circuit Court of Appeals for the sixth circuit held that there was power in the residue of that precinct not excepted to join with another in making this subscription and the joint bonds were properly issued therefor. The same charter provided that such subscriptions should be paid by taxes levied in such precincts alone. The appellate court held that the assessor for the payment of the bonds involved in the suit might be required to list separately the property of the district making such subscription, and liable to a tax therefor under the statutes of Kentucky which require him to make separate books for each "taxing district of his county, by wards or other subdivisions, as convenience may require."[1]

afford them relief. The established rule, though not of universal application, is that equity follows the law, or, as stated in Magniac *v.* Thomson, 15 How. 281, 291, 'that whenever the rights or the situation of parties are clearly defined and established by law equity has no power to change or unsettle those rights or that situation, but in all such instances the maxim *equitas sequitur legem* is strictly applicable.'"

[1] Breckenridge County *v.* McCracken, (1894) 61 Fed. Rep. 191. There was an objection on the part of the county that no power was conferred to assess a tax upon either the interest or principal of the bonds to be issued, and that, therefore, no authority to issue the bonds or subscribe for the stock had been conferred. LURTON, Circuit Judge, upon this objection, said: "To support this proposition counsel rely upon a doctrine to that effect in Kentucky Union R. Co. *v.* Bourbon Co., 85 Ky. 111; s. c., 2 S. W. Rep. 687. The same principle was laid down by Justice MILLER in Citizens' Savings & Loan Assn. *v.* City of Topeka, 20 Wall. 660, where it was said that 'the validity of a contract which can only be fulfilled by a resort to taxation depends on the power to levy the tax for that purpose.' The language was applied in a case where the validity of bonds issued by the city of Topeka to aid a private manufacturing establishment was in question. The court said, as

§ 448. The denomination of bonds changed from those named in the proposal under Alabama statutes — their validity not affected thereby.— The bonds from which the coupons upon which these actions were brought were detached, were issued in Alabama in sums of a different denomination from those named in the proposal of a railroad company receiving them, made to the county authorities under the statutes of that state relating to aid bonds. The validity of the bonds was questioned before the United States Supreme Court on account of this variance. Section 11 of the act under which the bonds were issued provided "that the bonds shall be of such denomination as the Court of County Commissioners and said railroad company may agree upon, but not to be for less than one hundred dollars nor more than one thousand dollars." In the proposition of the company to Greene county it was suggested that the bonds to be issued in payment of the subscription should be "in the sum of one and five hundred thousand dollars each." In the records of the court ordering the election the proposition, as recorded, was that the bonds be "in the sum of one thousand five hundred dollars each." The final action of the court was to issue bonds of $500. In the Pickens County case the proposition was that the bonds be in the sum of $1,000 each, but after the election, with the consent of the company, it was ordered by the court that one-half the amount should be in the sum of $250, and the other half $1,000, and the bonds actually put out were of these denominations. The court sustained the validity of the bonds over this objection.[1]

such bonds could only be paid by taxation they were void unless taxes might be constitutionally levied for the purpose of aiding a purely private enterprise. Here we have no such question, for, under the Constitution of Kentucky, taxes may be levied to aid a railway line, it being deemed a public enterprise. There can be in this case no serious doubt but that the power to assess a special tax upon the property of the affected district has been conferred on the County Court of Breckenridge county for the purpose of paying off the interest and principal of these bonds. Section 14 of the charter provides that 'an annual tax sufficient to pay the semi-annual installments of interest on such bonds, and the principal when it shall become due, shall be collected and paid out by the officers of such counties, cities or towns, as provided in the case of other county, city or town taxes.' The criticisms on this provision are (1) that no means are provided, and none existed before, for ascertaining the amount of taxable property in the unorganized district; (2) that in attempting to confer the taxing power it does so by referring to a criterion which has no existence in law. We think these objections quite untenable. The power to assess, levy and collect a tax would be necessarily implied from the power to create the debt, there being nothing in the act indicating an expectation that payment should be made in any other way, and no constitutional obstacle, either in the character of the debt or to the granting of such power by the legislature, being suggested. Citizens' Savings & Loan Assn. *v.* City of Topeka, 20 Wall. 656; Ralls Co. *v.* U. S., 105 U. S. 735; Quincy *v.* Jackson, 113 U. S. 335; s. c., 5 Sup. Ct. Rep. 544. The purpose that this debt shall be paid by taxation is made clear. That no general authority exists to levy an *ad valorem* tax for general county purposes is not important. The power to assess and levy a special *ad valorem* tax is by implication clearly conferred in section 14, to say nothing of the implication which results from the grant of power to create the debt and then the bonds."

§ 449. What amounts to a gift of bonds in aid not authorized.—A statute of Illinois incorporating a railroad company empowered municipal corporations, when authorized by popular vote, to subscribe for stock in the company and issue bonds in payment therefor. A county agreed, by popular vote, to subscribe for $100,000 of stock and issue bonds therefor, but before issuance of the bonds the county authorities agreed to sell the stock back to the company in exchange for $5,000 in bonds. In fact, only $95,000 of bonds were issued and delivered to the company and no stock received by the county. The United States Circuit Court of Appeals for the seventh circuit held that the bonds were void, as the transaction, being a gift and not a subscription, was not authorized by the statute nor assented to by the popular vote.[2]

[1] County of Greene *v.* Daniel, (1880) 102 U. S. 187; County of Pickens *v.* Daniel, (1880) 102 U. S. 187. Chief Justice WAITE, for the court, said: "As to the Greene County case, it is apparent that there was a clerical mistake, either in the proposal or the record, as to the description of the bonds to be issued, and it is easy to see that the intention was to have bonds of a thousand dollars and five hundred dollars each, but in the Pickens County case the proposition was distinctly that they should be for one thousand dollars. This, however, we consider unimportant, for section 11 expressly provides for bonds of such denomination as the Commissioners' Court and the company should agree on. From this it is clear that the parties were not bound in this particular by the sums specified in the proposal. They were limited by the proposition as accepted in respect to the total amount of the issue, but not the denomination. The bonds as issued were of such denominations as the law allowed the court and the company to agree on, and that, in our opinion, is enough."

[2] Post *v.* Pulaski County, (1892) 49 Fed. Rep. 628. BLODGETT, D. J., said: "No special or general statute of the state then in force authorized the county to make a donation of its money or bonds in aid of this railroad

§ 450. Consolidation of railways — effect as to county aid. — In an action by a railroad company against the county commissioners of an Indiana county, praying that there be awarded to them, by way of subrogation, a sum of money which had been, as alleged, awarded in aid of certain railroad companies, these rules were declared: A general statute authorizing the consolidation of railroad companies must be considered a silent factor in a subsequent contract of subscription made by a township to the stock of a railroad company, and a consolidation of such company with another company will not release the township, but will transfer its obligation to the new company. In Indiana a mere vote by a township of a given sum in aid of a railroad gives the company no legal right to or interest in the tax until the same has been levied and collected, and a valid contract of subscription made in behalf of the township. And if it be conceded that such

company. That there is an essential difference between a proposition to subscribe for stock in a railroad company, and thereby become a stockholder, with a right to share in the profits of its business and have a voice in the management and policy of the company, and a proposition to make a donation of bonds or money to the railroad company is too plain to require argument or the citation of authority. The order of the County Court, making the subscription to the stock and directing the issue of the bonds, and which must be read into each bond and coupon, shows in unmistakable language, so plain that it requires no technical skill to construe or apply it, that the bonds were issued as a donation to the railroad company and not in payment of a subscription to its stock. The case of Choisser *v.* People, 140 Ill. 21; s. c., 29 N. E. Rep. 546, lately decided by the Supreme Court of Illinois, * * * is almost identical in its facts, as far as the questions now under consideration are concerned, with this case. It involved an issue of bonds by another county (Saline) in aid of the construction of the same railroad, and in pursuance of the same section of the charter of the railroad company. An agreement between that county and the railroad company was made after the vote authorizing the subscription, in substantially the same terms as was made in the case now under consideration. And in that case the court, speaking by Mr. Justice BAILEY, said, in regard to this contract: 'That in its consummation, if not in its inception, the transaction was a donation, pure and simple, is too plain to admit of serious controversy. In the beginning, and until the election was had, the guise of a subscription was resorted to so as to bring the municipal aid sought to be obtained apparently at least within the power conferred upon the county by the tenth section of the railroad company's charter. But, when viewed in the light of the interpretation put upon the transaction by the subsequent acts of the parties, it appears too transparent to mislead. The bonds being essentially a donation, it was not within the power of the County Court to issue them, and they must, therefore, be held to be *ultra vires* and void.'"

a vote gives a contingent interest which will pass to a new company by consolidation, such new company cannot assert any claim to the fund when it has not tendered the stock therefor, and has no stock which it may legally tender.[1] A township of Missouri having subscribed in aid of a railroad company, a Missouri corporation, under the laws of that state, by a vote, which railroad company, under a statute authorizing it, was afterwards consolidated with a railroad company which was an Iowa corporation, and the bonds were subsequently issued to the latter, upon the question of the effect of the consolidation and the rights of the parties involved, the Supreme Court of the United States sustained the validity of the county bonds issued on behalf of the township. They held that the consolidation was authorized, and the right to receive the subscription passed to the consolidated company; further, that the vote on the subject of the subscription contemplating the construction of the railroad which the consolidated company built, there was no diversion from the purpose contemplated by the vote, in the fact that the stock was subscribed and the bonds issued to the consolidated company.[2] In a case where the Supreme Court of the United States held that a subscription of stock and issue of county bonds, authorized upon a vote of the people of the county to the original corporation, could not be legally made to one of the three new corporations into which, by an amendatory act, the legislature of Illinois had divided the original corporation, it was contended that the plain-

[1] Pope *v.* Board of Comrs. of Lake County, (1892) 51 Fed. Rep. 769, in which the court overruled the demurrer to the intervening petition of the townships and a taxpayer asserting their rights to the fund. See Board Comrs. Hamilton Co. *v.* State, 115 Ind. 64; s. c., 4 N. E. Rep. 589, and 17 N. E. Rep. 855; Centre Township *v.* Board, etc., 70 Ind. 562, as to the rights of the township where the right of the railroad to aid has never existed, or has ceased to exist.

[2] Livingston County *v.* First National Bank of Portsmouth, (1888) 128 U. S. 102. Mr. Justice BLATCHFORD, in the opinion rendered in this case, reviews at length the following cases involving consolidation of the companies to which aid is voted with other companies, and under other names: County of Scotland *v.* Thomas, 94 U. S. 682; Town of East Lincoln *v.* Davenport, 94 U. S. 801; Wilson *v.* Salamanca, 99 U. S. 499; Menasha *v.* Hazard, 102 U. S. 81; Harter *v.* Kernochan, 103 U. S. 562; New Buffalo *v.* Iron Company, 105 U. S. 73; Nugent *v.* The Supervisors, 19 Wall. 241; Empire *v.* Darlington, 101 U. S. 87; County of Tipton *v.* Locomotive Works, 103 U. S. 523. He commented, also, upon County of Bates *v.* Winters, 97 U. S. 83; Bates County *v.* Winters, 112 U. S. 325; Harshman *v.* Bates County, 92 U. S. 569.

tiff was an innocent purchaser of the bonds without notice of their invalidity. Mr. Justice FIELD, speaking for the court, said: "If such were the fact we do not perceive how it could affect the liability of the [county issuing the bonds]. This is not a case where the party executing the instruments possessed a general capacity to contract, and where the instruments might, for such reason, be taken without special inquiry into their validity. It is a case where the power to contract never existed — where the instruments might, with equal authority, have been issued by any other citizen of the county. It is a case, too, where the holder was bound to look to the action of the officers of the county and ascertain whether the law had been so far followed by them as to justify the issue of the bonds. The authority to contract must exist before any protection, as an innocent purchaser, can be claimed by the holder. This is the law even as respects commercial paper, alleged to have been issued under a delegated authority, and is stated in the case of Floyd Acceptances, 7 Wall. 676." In speaking of notes and bills issued or accepted by an agent, acting under a general or special power, the court says: "In each case the person dealing with the agent, knowing that he acts only by virtue of a delegated power, must, at his peril, see that the paper on which he relies comes within the power under which the agent acts. And this applies to every person who takes the paper afterwards; for it is to be kept in mind that the protection which commercial usage throws around negotiable paper cannot be used to establish the authority by which it was originally issued."[1] A county of Tennessee, lawfully authorized to issue its bonds in payment of a subscription to a railroad corporation of that state, through its County Court subscribed to the stock and issued its bonds and delivered them to the corporation. Between the Tennessee railroad company and another, a Kentucky corporation, a consolidation was about to take place. Before this step was taken the Kentucky company, through its agent, submitted the following proposition to the County Court, which represented the county issuing the bonds, to wit: "That this company will grant an extension of time for the payment of said bonds and interest, so that the said payments shall be extended to the period of ten years from the date of the bonds, in ten annual installments, instead of the time

[1] Marsh *v.* Fulton County, (1870) 10 Wall. 676, 683.

they now have to run; this extension to apply to all bonds which this company owns or controls. But this proposition should be made a condition that the County Court of [the county issuing the bonds] shall immediately levy a tax and proceed to its collection, for the amount now due under this offer, and that they shall each year levy, collect and promptly pay over the amount to fall due each year, as the same falls due, during the whole period of this proposed extension; and in case of failure to levy, collect, or promptly pay over said annual amount, then the remaining bonds to become due, according to their original terms." The County Court, it appeared, accepted this proposition and the two roads were consolidated under another name, and under the control of the Kentucky corporation the road was constructed through the Tennessee county and to its final terminal point in that state. These bonds were used by the consolidated company for the purposes of this construction and the equipment of the road, and in due course of trade, for value, and in good faith, passed to the holder who brought an action upon them, the county claiming as a defense that there was fraud and collusion in the procuration of and issue of the bonds originally to the Tennessee company and that they were void for that reason. The United States Supreme Court held that there was no error in the instructions of the Circuit Court to the jury on the trial of the case, and that the county was estopped from denying the validity of the bonds in the hands of a *bona fide* holder, to whom they were transferred for value by the consolidated company.[1] The line of a consolidated railroad corporation, when completed according to its charter, must form a continuous track with those of the other constituents of the consolidated corporation, so as to admit of the passage of trains without break or interruption before the power of one of the constituent corporations to acquire land in aid of the construction of its road will pass to the consolidated corporation.[2]

§ 451. Constitutionality of a Tennessee aid statute.— The general statute of Tennessee required the County Courts, when thereunto authorized by a popular vote at an election held for the purpose, to subscribe for stock in a railroad company. A

[1] County of Tipton *v.* Locomotive Works, (1880) 103 U. S. 523.

[2] Georgia Pac. Ry. Co. *v.* Gaines, 88 Ala. 377; s. c., 7 So. Rep. 382, following Railway Co. *v.* Wilkes, (Ala.) 6 So. Rep. 34.

special statute was subsequently passed, which, without requiring the submission of the question of subscription to a popular vote, conferred power on the County Courts of the counties on the line of a particular railroad to make, and on the company to receive, a subscription of its stock. In an action upon bonds issued under this last act, it was contended that the last-mentioned statute was in violation of the Constitution of the state of Tennessee. The United States Supreme Court sustained the constitutionality of the statute.[1]

§ 452. Ratification of bonds.—There was in a case before the United States Supreme Court also this contention, that if the bonds in suit were issued without authority their issue was subsequently ratified, and various acts of the supervisors of the county were cited in support of the supposed ratification. To this it was said by the court: "These acts fall very far short of showing any attempted ratification even by the supervisors. But the answer to them all is that the power of ratification did not lie with the supervisors. A ratification is, in its effect upon the act of an agent, equivalent to the possession by him of a previous authority. It operates upon the act ratified in the same manner as though the authority of the agent to do the act existed originally. It follows that a ratification can only be made when the party ratifying possesses the power to perform the act ratified. The supervisors possessed no authority to make the subscription or issue the bonds in the first instance without previous sanction

[1] County of Tipton *v.* Locomotive Works, (1880) 103 U. S. 523. The court considered the effect of the rulings in all the cases before the Tennessee court, with an elaborate discussion of the principal cases, and Mr. Justice HARLAN, speaking for the court, said: "Looking, then, as well at the language of the Constitution [of Tennessee, 1834] as at the course of decision in the Supreme Court of Tennessee up to the time the acts of 1867 and 1869 were passed, and giving full effect to its latest utterance, to which our attention has been called, and remembering, also, that the power given to a municipal corporation to subscribe to the stock of a railroad company may be, also, a right and privilege of that company (County of Scotland *v.* Thomas, 94 U. S. 682; Wilson *v.* Salamanca, 99 U. S. 499; Empire *v.* Darlington, 101 U. S. 87, 91), our conclusion is that those acts were not repugnant to the Constitution of the state, by reason of the authority they confer on a limited number of counties to make, and on a particular railroad corporation to receive, a subscription of stock, nor because they dispensed with the previous assent of the people of such counties expressed at a popular election."

of the qualified voters of the county. The supervisors in that particular were the mere agents of the county. They could not, therefore, ratify a subscription without a vote of the county, because they could not make a subscription in the first instance without such authorization. It would be absurd to say that they could, without such vote, by simple expressions of approval or in some other indirect way give validity to acts when they were directly in terms prohibited by statute from doing those acts until after such vote was had. That would be equivalent to saying that an agent, not having the power to do a particular act for his principal, could give validity to such act by its indirect recognition."[1] The court took occasion, however, to say: "We do not mean to intimate that liabilities may not be incurred by counties independent of the statute. Undoubtedly they may be. The obligation to do justice rests upon all persons, natural and artificial, and if a county obtains the money or property of others without authority, the law, independent of any statute, will compel restitution or compensation. But this is a very different thing from enforcing an obligation attempted to be created in one way when the statute declares that it shall be created in another and different way."[2]

§ 453. Rules as to statutes legalizing a prior issue of bonds.— Where an election authorizing aid bonds was absolutely void, because called and ordered by persons not authorized, the legislature of Illinois was held to be powerless under the State Constitution to validate bonds issued under the vote by subsequent enactment and require the issuing of the bonds peremptorily.[3] The United States Supreme Court has sustained the validity of certain statutes legalizing municipal subscriptions where the subscription to stock and issue of bonds in aid of railroads have been effected by not strictly complying with the laws in the matter of election of the voters upon the subject or otherwise, as only giving effect to the wishes of the corporate authorities.[4] A statute subsequently passed by the Illinois legislature

[1] Citing McCracken *v.* City of San Francisco, 16 Cal. 624.

[2] Marsh *v.* Fulton County, (1870) 10 Wall. 676, 683, 684.

[3] Gaddis *v.* Richland County, 92 Ill. 119.

[4] Bolles *v.* Brimfield, (1887) 120 U. S. 759; Anderson *v.* Santa Anna, 116 U. S. 356; Grenada County Supervisors *v.* Brogden, 112 U. S. 261. Municipal aid bonds held not validated by an act of the legislature ratifying them in

amended the charter of this railroad company and attempted in such amendments to validate all contracts between the company and municipalities, whereby the municipalities agreed to sell to the railroad company at a nominal price the stock for which they had subscribed. The curative effect of this statute was urged upon the United States Circuit Court of Appeals for the seventh circuit, but the court held the statute had no effect where the contract was made by the municipal authorities without being admitted to popular vote, as required by law, the legislature not having the power to impose an obligation upon a municipality without its consent legally expressed.[1]

Williams *v.* People, 132 Ill. 574; s. c., 24 N. E. Rep. 647; disapproving Jonesboro City *v.* Railroad Co., 110 U. S. 192; s. c., 4 Sup. Ct. Rep. 67. The effect of a curative act of the legislature. Atchison, Texas & Santa Fe R. R. Co. *v.* Jefferson County, 17 Kans. 29.

[1] Post *v.* Pulaski County, (1892) 49 Fed. Rep. 628. BLODGETT, D. J., said: "In reference to the validity of the statute, we cannot express our own views more clearly or forcibly than by quoting from the opinion of [Mr. Justice BAILEY] in the case [of Choisser *v.* People, 140 Ill. 21; s. c., 29 N. E. Rep. 546] in which he says: 'The only proposition which had been submitted to the vote of the people of the county, and the only proposition which, under existing laws, the County Court had power to submit to them, was that of making a subscription to the capital stock of the railroad company, the stock to be received as the consideration, and, presumably, the equivalent, for the county bonds to be issued in pursuance of the subscription. The proposition to donate ninety-five thousand dollars in county bonds to said railroad company was never submitted to the people of said county, was never voted upon by them, and could not, under the existing laws, have been submitted to such vote. The subsequent contract entered into by the County Court, to sell back the stock subscribed for, for a nominal consideration, so as to effectually terminate the proposition to subscribe one hundred thousand dollars to the capital stock of said company, to which the people of the county had given their assent, into a proposition to donate to the railroad company ninety-five thousand dollars of county bonds, to which the people of the county had not, and could not have, given their assent, was clearly void, so as to confer no rights and impose no obligations. * * * In the present case the amendatory act of 1869, if effectual at all, can be held to operate only by way of validating a contract for a donation which, by reason of want of power, as well as the absence of either an intention or opportunity on the part of the legal voters of the county to give their assent to it, was *ultra vires* and void. Declaring such void contract to be valid and binding, and providing that it should be carried into effect in good faith, as said amendatory act undertook to do, was an attempt to impose upon the county an obligation in aid of the railroad without its own consent, expressed in any legal form." Where a subsequent act legalizing the proceedings of a county in subscribing to, and paying for, stock of a railroad company was held to have cured all defects, see Hall *v.*

§ 454. Recitals on face of aid bonds — their effect.— A recital in county bonds, that they are issued "pursuant to an order of the County Court," puts all persons dealing in the bonds upon inquiry as to the terms of the order.[1] Where there was a recital in a municipal bond that it was issued in payment of a subscription made in pursuance of a vote of the people at an election specified in the recital, and there was no law authorizing such election and subscription, the holder of the bond was held to have notice by the recital of the illegality of the subscription.[2] Should bonds purporting to have been issued by a county contain no recitals of an election, or of proceedings and orders of the county authorities, being mere promises to pay, purchasers or holders of the bonds will be chargeable with notice of whatever appears upon the face of the county records.[3] A purchaser of county bonds issued in aid of a railroad company is not bound to go behind the records, and where such records show enough upon the matter of authority to issue the bonds to justify him in taking them, he cannot be required to go behind them and show that the record is true. He may rely upon the records for the facts stated in relation to he vote of the county authorizing the subscription to the stock. And the county cannot afterwards question the regularity of its own proceedings.[4] Under its general powers to lend its credit in

Baker, 74 Wis. 118; s. c., 42 N. W. Rep. 104.

[1] Post *v.* Pulaski County, (1892) 49 Fed. Rep. 628.

[2] Barnes *v.* Town of Lacon, 84 Ill. 461.

[3] Lewis *v.* Bourbon County, 12 Kans. 186.

[4] Clapp *v.* County of Cedar, 5 Iowa, 15; Meyer *v.* Muscatine, 1 Wall. 384; Lynde *v.* Winnebago County, 16 Wall. 6. See Livingston County *v.* First National Bank of Portsmouth, (1888) 128 U. S. 102, as to what recitals and under what statement of facts, a county would be estopped from urging as against a *bona fide* holder of the bonds of the county issued in aid of a railroad company, the existence of any mere irregularity in the making of the subscription or the issuing of the bonds. In Kimball *v.* Town of Lakeland, (1890) 41 Fed. Rep. 289, it appeared that the General Statutes of Minnesota authorized municipal corporations to issue railroad aid bonds, provided an agreement is reached between the railroad company and the municipality in either one of two modes. In 1879 this act was amended so as to allow but one mode of making such agreement. In 1880 the bonds of this town were issued in pursuance of the act, upon an agreement entered into in the mode which had been repealed. The bonds recited that they were issued under the act, and that all the conditions of the act had been complied with. The federal court held that the recital in the bonds estopped the town from denying the validity of the bonds as against a *bona*

aid of railroads, a county in Kansas issued bonds in exchange for the stock of a railroad company on condition that the company build a railroad of standard gauge through the county. In issuing the bonds all the formalities required by the law, on the part of the county, were complied with. The United States Circuit Court of Appeals for the eighth circuit held that the county could not set up the defense of *ultra vires* to the action on the bonds, because the railroad company was authorized to build only a narrow-gauge railroad. These bonds bore on their face recitals that they were issued to the railroad company in payment of a subscription for stock, made by virtue of an act of the legislature (the title and date of which were given), and acts amendatory of the same, with this further statement on each bond, "the provisions and requirements of said acts, and the conditions prescribed necessary to the subscription aforesaid, and the lawful issue of this bond, having been in all respects fully and completely complied with and performed." The defense of *ultra vires* was held not to be available in the action as against a *bona fide* purchaser for value on the faith of the recitals, and without notice that the company was authorized to construct only a narrow-gauge road, and that the bonds were issued on condition that the road should be, as it in fact was, of standard gauge.[1]

fide holder for value. Citing Fulton *v.* Town of Riverton, 42 Minn. 395; s. c., 44 N. W. Rep. 257.

[1] Board of Comrs. of Kingman County *v.* Cornell University, (1893) 57 Fed. Rep. 149. It was said in the opinion: "The general doctrine is that where a contract or undertaking which has been entered into by a corporation is simply in excess of its charter powers, and the same has been fully executed, the defense of *ultra vires* cannot be successfully pleaded in a suit to enforce negotiable securities or other obligations which have issued out of the original transaction. In such cases the state is entitled to restrain the offending corporation from exercising powers that do not belong to it, or to oust it of its franchises, in a proper proceeding brought for that purpose, but it is ordinarily held that in collateral suits between private litigants the plea of *ultra vires* is not available as a defense. Bank *v.* North, 4 Johns. Ch. 370; Bank *v.* Matthews, 98 U. S. 621; Gold Mining Co. *v.* National Bank, 96 U. S. 640; Whitney Arms Co. *v.* Barlow, 63 N. Y. 62; Bradley *v.* Ballard, 55 Ill. 417; Ditch Co. *v.* Zellerbach, 37 Cal. 543; Argenti *v.* City of San Francisco, 16 Cal. 255; Allegheny City *v.* McClurkan, 14 Pa. St. 81. * * * In the case of County of Macon *v.* Shores, 97 U. S. 272, it appeared that county aid had been granted to a railroad company in the form of a stock subscription and by an issuance of bonds, although the company had not accepted its charter and become organized as a corporation within the time limited by law for such acceptance of the charter and for organization thereunder. In a suit against the county upon the bonds, it was held that a plea that the company had not become organized within the time limited by law constituted no defense as against an innocent purchaser of the securities. The same ruling was repeated in the case of County of Ralls *v.* Douglass, 105 U. S. 728, and in the latter case it was also held that it was not competent for the county to show by way of defense, as against an innocent purchaser of its bonds, that when they were executed a person was acting as presiding judge of the County Court who was not *de jure* a member of the court. It seems to be settled by these decisions that a purchaser for value of railroad aid bonds is not required to ascertain and to determine at his peril whether the railway corporation to whom they were voted and issued was at the time duly and regularly constituted * * *."

[1] County of Greene *v.* Daniel, (1880) 102 U. S. 187; County of Pickens *v.* Daniel, (1880) 102 U. S. 187. Chief Justice WAITE referred to the statutes of Alabama relating to granting aid to railroads, and to the cases of Shinbone *v.* Randolph County, 56 Ala. 183; Commissioners' Court of Limestone County *v.* Rather, 48 Ala. 433. Then he said: "The bonds and coupons in these cases were signed by the judge of probate of the county, as the presiding officer of the Commissioners' Court, and it seems to us that they are, in legal effect, themselves warrants on the treasurer, given by the judge of probate after an allowance by the court of the claim of the railroad company for the payment of the county subscription in accordance with the terms of the accepted proposal. The claim was, to all intents and purposes, audited by the court when the bonds were issued. The validity and amount of the liability were then definitely fixed, and warrants on the treasury given payable at a future day. The treasurer could pay them when due on presentation without further action of the court, if he had funds in his hands applicable to that purpose. In his hands they would be good vouchers for money disbursed from that fund. The provision that the coupons should be received in payment of taxes levied to meet them is entirely consistent with any idea of an unliquidated claim which required further auditing." Then, addressing himself to the remedy if such bonds or coupons were unpaid when due, the chief justice said:

§ 455. Bonds and coupons not claims which require presentation to county authorities before suit.—In a case involving county bonds issued in Alabama in aid of a railroad company, before the United States Supreme Court, the question of whether or not an action could be maintained upon bonds or coupons which had been attached to such bonds where they had not been presented to the Court of County Commissioners for allowance before the suit was brought, was fully discussed by that court. The result of the consideration by the court of the statutes of Alabama and the cases determined by the Supreme Court of that state, was a holding that the action was maintainable, and that the bonds and coupons did not constitute such claims as should be presented for action to the county authorities before suit could be brought upon them.[1]

§ 456. Coupons — rules governing.— A coupon attached to a bond issued by a county in payment of its subscription to the stock of a railroad corporation, under the authority given it by the legislature, will not be invalidated by the fact that the coupon is made payable in New York or elsewhere than at the treasury of the county issuing it.[1] Coupons for the payment of interest,

"In the state courts, under the rule as stated in Shinbone *v.* Randolph Co., 56 Ala. 183, and other cases, a *mandamus* would lie without reducing the coupons to judgment, to compel the Commissioners' Court to levy and collect the taxes necessary to pay what was due. The rule is different, however, in the courts of the United States, where such a writ can only be granted in aid of an existing jurisdiction. There a judgment at law on the coupons is necessary to support such a writ. The *mandamus* is in the nature of an execution to carry the judgment into effect. Bath County *v.* Amy, 13 Wall. 244; Graham *v.* Norton, 15 Wall. 427. A suit, therefore, to get judgment on the bonds or coupons is part of the necessary machinery which the courts of the United States must use in enforcing the claim, and the jurisdiction of those courts is not to be ousted simply because in the courts of the state a remedy may be afforded in another way."

[1] Johnson *v.* County of Stark, (1860) 24 Ill. 75. It was said by the court: "It was held by this court, in the case of The People ex rel. *v.* Tazewell County, 22 Ill. 147, that counties and municipal corporations, unless specially authorized by legislative enactment, have no power to make their indebtedness payable at any other place than at their treasury. That proceeding was an application for a writ of *mandamus*, to compel the board of supervisors to issue bonds and coupons, payable in the city of New York. The application was based upon a demand of such bonds and coupons; and as there had been no demand of such securities payable at the county treasury, the question now under consideration was not then before the court, and was not determined. The board of supervisors could not be in default until they had refused to issue bonds and coupons, authorized by law, upon a proper demand. No such demand was made in that case, and, therefore, the court could not compel them to proceed to issue such securities. This case presents the question, whether instruments evidencing their indebtedness payable specifically at any other place are void, or whether they may be upheld as payable at their treasury. This coupon on its face purports to be payable at the city of New York. The doctrine is well recognized that in exercising a power, all acts performed in excess of, or beyond, the power delegated, must be rejected as unwarranted; and if, after their rejection, there has been enough done to show a proper execution of the power, the act will be sustained, irrespective of the acts beyond the power delegated. But, on the contrary, if the acts performed beyond the authority conferred, are so inseparably connected with the acts properly performed, that, by their rejection, the power remains unexecuted, then the whole transaction must be rejected as void. When tested by this rule, it will be perceived that this coupon may be sustained as valid, and payable at the treasury of the county. The law authorized the county to issue it, and

executed at the same time and attached to municipal bonds and referred to therein, when detached are negotiable, and when matured, action may be brought upon the coupons against the corporation issuing them, provided it had power to issue the bonds.[1] Coupons attached to municipal bonds, payable to bearer, for a sum certain, assimilate to bank bills. They pass by delivery only, and may be offered in evidence under the common money counts appropriate to an action upon them.[2] The holder of an unindorsed coupon detached from a bond of a municipality is entitled to demand payment of the same, and, if refused, to sue for and recover the money in his own name.[3] Municipal bonds with coupons payable to bearer, being negotiable securities, and having all the qualities and incidents of negotiable paper, and the coupons negotiable like the bonds, it is not necessary that the holder of the coupon, in order to recover, should own the

requires no place of payment to be named. And where none is specified, it, by operation of law, is payable at the treasury. If this coupon had not contained the language, 'at the city of New York,' it would have been a legal instrument, strictly conforming to all the requirements of the law authorizing counties to issue evidences of indebtedness. If then this unauthorized portion of the coupon were rejected, it would be in conformity to the law, and, for the purpose of upholding it, the law will reject that portion as surplusage. This doctrine was announced by the very able district judge of United States District Court for Wisconsin in the case of Mygatt *v.* City of Green Bay, 1 Biss. 292, which was precisely similar to this case."

[1] Town of Cicero *v.* Clifford, 53 Ind. 191.

[2] Board of Supervisors of Mercer County *v.* Hubbard, (1867) 45 Ill. 139.

[3] Johnson *v.* County of Stark, (1860) 24 Ill. 75. It was contended in this case that the plaintiff had no legal title to the coupon sued on. The bond to which it was annexed was duly assigned to him, but there was no indorsement on the coupon. The court said: "It seems to be the well-settled doctrine that state, county, city and other bonds, and public securities of this character, are negotiable by delivery only, without indorsement, in the same manner as bank bills, especially when they are payable to bearer. Redf. on Rys. 595, and authorities cited. It is true that this coupon names no person as payee, nor is it specifically payable to bearer. But the promise is 'to pay sixty dollars on this coupon.' The promise is to pay the sum named in the instrument, and it can only be demanded by the person holding it, and precisely as if it was payable in terms to bearer. There is no room to doubt that the specified amount, by the terms of the agreement, is payable to, and may be demanded by, the holder after its maturity. Its legal effect is, that the money is to be paid on the coupon, and to the holder presenting it for that purpose."

bonds from which they are detached.[1] The defense cannot be made in an action upon coupons detached from municipal bonds that they are signed by only one of the county officers, where the bonds to which they were attached are properly signed and sealed by the officers of the county.[2]

§ 457. A county suable on precinct bonds.— The charter of this Kentucky railroad company authorized magisterial precincts of any county through which it passed to subscribe to its capital stock, and provided that the bonds of the county should be issued in payment of such a subscription in every respect as if such subscription was made by the county, but that such precincts should be alone bound to pay such bonds. Before the United States Circuit Court of Appeals for the sixth circuit it was objected that the county was not liable on the bonds, and that it was error in the action thereon to have rendered judgment against the county. The court held that the county was liable to actions on such bonds, but judgment against it was to be satisfied out of a tax levied on the precincts alone.[3]

[1] Thompson *v.* Lee County, 3 Wall. 327.

[2] Thayer *v.* Montgomery County, 3 Dill. 389. That interest is recoverable upon overdue coupons, see Genoa *v.* Woodruff, 92 U. S. 502; Walnut *v.* Wade, 103 U. S. 683; Koshkonong *v.* Burton, 104 U. S. 668; Aurora City *v.* West, 7 Wall. 82; Cromwell *v.* County of Sac, 96 U. S. 51; Hollingsworth *v.* Detroit, 3 McLean, 472; Beaver *v.* Armstrong, 44 Pa. St. 63; Mills *v.* Jefferson, 20 Wis. 50; Burroughs *v.* Richmond County, 65 N. C. 234; McLendon *v.* Anson County, 71 N. C. 38; Davis *v.* Yuba, 75 Cal. 452.

[3] Breckinridge County *v.* McCracken, (1894) 61 Fed. Rep. 191. The court said: "The districts subscribing were not corporations, and could not, without further legislation, execute and deliver bonds. Some one could be authorized to become the obligor. This duty was imposed on the county. This was authorized under the [following Kentucky decisions: City of Lexington *v.* McQuillan's Heirs, 9 Dana, 513; County Judge of Shelby County *v.* Shelby R. Co., 5 Bush, 226; Kreiger *v.* Railroad Co., 84 Ky. 66; Allison *v.* Railway Co., 10 Bush, 1. See, also, Carter Co. *v.* Sinton, 120 U. S. 518; s. c., 7 Sup. Ct. Rep. 650; Hancock *v.* Railroad Co., 145 U. S. 414; s. c., 12 Sup. Ct. Rep. 969]. * * * While the district subscribing is the debtor, yet in form the county is the obligor. Through the county the indebted district is to act, and through the same agency the indebted district is to be coerced by the assessment of the tax essential to meet its obligations. Such a district becomes, for the purposes of the subscription, a corporation *quoad hoc*. Kreiger *v.* Railroad Co., 84 Ky. 66; Hancock *v.* Railroad Co., 145 U. S. 409. It is suable only through the county which, in respect to the subscription, the issuance of the bonds, and the assessment of a special levy stands for and represents the debtor. The judgment was properly rendered against the county, collectible only from tax levied on property in the indebted district. The charter, in this respect, is substantially like the provision construed in Davenport *v.* Dodge Co., 105 U. S. 237." In Blair *v.* Cuming County, 111 U. S. 363, a case of bonds issued under a vote of a precinct in aid of a public improvement, a case from the district of Nebraska, Mr. Justice BLATCHFORD, for the United States Supreme Court discussed this same question in these words: "This question was decided by this court in Davenport *v.* County of Dodge, 105 U. S. 237, in regard to precinct bonds issued under the same statute, and it was held that a suit against the county on coupons cut from special bonds issued by the county commissioners for the precinct, was a proper suit." It was also contended that the statute required that precinct bonds should be issued as special county bonds for the precinct by the county commissioners, and did not authorize the chairman of the board and its clerk to issue the bonds; that the county commissioners could not delegate their authority to sign and issue the bonds to any one else, or to one of their number; and that precinct bonds signed by one of the county commissioners as chairman, and attested by the clerk of the board, and coupons signed by some one as clerk, had no validity. To this it was said: "We see no force in these objections. The bonds bear the seal of the county, and purport to be issued by the board of county commissioners on behalf of the precinct. The bond states that the board, in testimony of the statements in the bond, has caused the bond to be signed in behalf of the precinct, by the chairman of the board, and to be attested by the clerk of the board (who appears by the petition to have been the clerk of the county), and that such clerk has affixed thereto the seal of the county. This was a sufficient compliance with the statute. The commissioners by statute constituted a 'board.' That was their official designation when meeting to perform any duties with which they were charged. See Gen. Stats. Neb. (1873) chap. 13, §§ 7, 14, pp. 233, 234. The attestation of the bonds by the signatures of the chairman and clerk of the board and the county seal, was proper. It was not necessary that all the commissioners should sign the bonds. What was done was not an issuing of the bonds by the chairman and clerk. The coupons in the form in which they were issued, annexed to the bond, were adopted as coupons by the statement in the body of the bond, and the question as to any one of them, when detached, is only one of genuineness and identity. The bonds are special bonds for the precinct, and contain a sufficient statement showing their special nature, that is, that they are special bonds for the precinct."

§ 458. Rules as to pleading in such cases.— A simple allegation in the petition in an action on railroad aid bonds that "an election was duly held" to determine whether the subscription should be made, has been held to be sufficient.[1] And the plain-

[1] Breckenridge County *v.* McCracken, (1894) 61 Fed. Rep. 191. It was said by the court: "This is substantially an averment that the election was held according to the requirements of the law. It was not, however, important that the pleader should aver the preliminary facts requisite to the exercise of the power granted by the legislature to subscribe for the stock and issue bonds in payment. The

tiff in such an action need not allege a reservation made in the bonds by the county as to the time of payment, where there was no such reservation in the act authorizing the subscription, or the power to restore the bonds was in no wise affected thereby.[1] In Edwards *v.* Bates County, 55 Fed. Rep. 436, it was held that an offer by the county, within the statutory period of limitation, to compromise its bonds at a specified percentage, which offer was declined by the holders of the bonds in suit, although accepted by the holders of all of its other bonds, was not a promise to pay or an acknowledgment of the debt, which would interrupt the running of the Statute of Limitations.[2]

power to hold an election, subscribe for stock, and issue the bonds is averred. If there was any defect in the steps preliminary to the exercise of that power, it is for the defendant to plead and show such irregularity. The performance or non-performance of acts requisite to the valid exercise of the power are matters of defense. This precise question arose in Lincoln Tp. *v.* Cambria Iron Co., 103 U. S. 412. The declaration in a suit upon certain bonds issued by a Michigan township, did not aver that an election was held to authorize the issuance of the bonds, as required by law, and did not aver certain other prerequisites to such issue. After considering the effect of a verdict for the plaintiff as a waiver of such objection to the pleading, the court said: 'But we do not think that there was any defect in the declaration to be cured. We think that it would have been good on demurrer. The township had authority by law to issue its bonds by way of a donation to a railroad. It did issue its bonds. They got into circulation as commercial securities and were purchased by the plaintiff. All the plaintiff had to do in case of non-payment was simply to sue on the bonds. If there was any defense to them by reason of want of performance of any of the requisites necessary to give them validity, or for any other cause, it was for the defendant to show it. A bond, especially a negotiable bond, is a *prima facie* obligation of the obligor, if he has capacity to make it, and is binding according to the terms and conditions apparent on its face, until the contrary be shown. Whether an alleged defense, when set up, is or is not good against the particular holder, is to be determined by the court in each case.' 103 U. S. 416. The case of Hopper *v.* Town of Covington, 118 U. S. 148; s. c., 6 Sup. Ct. Rep. 1025, is relied upon by the appellant. It is not in point. The defect in the declaration went to the power of the corporation. In that very case the court drew a distinction between the want of power and an irregularity in the exercise of the power. See, also, County of Clay *v.* Society for Savings, 104 U. S. 586."

[1] Breckenridge County *v.* McCracken, (1894) 61 Fed. Rep. 191.

[2] As to liability of a county on precinct bonds, see Blair *v.* Cuming County, 111 U. S. 363; Nemaha County *v.* Frank, 120 U. S. 41. Cases in which the bonds were held valid, Lewis *v.* Pima County, 15 Sup. Ct. Rep. 22; Wilmington, O. & E. C. R. R. Co. *v.* Board of Comrs. Onslow County, (N. C.) 21 S. E. Rep. 205. Where they were held to be invalid, Citizens' Sav. & Loan Assn. *v.* Perry County, 15 Sup. Ct. Rep. 547; German Savings Bank *v.* Franklin County, 128 U. S. 526.

CHAPTER XXIII.

MUNICIPAL AID BONDS — CITY.

§ 459. City aid bonds, generally.
460. Rules as to such bonds settled in United States Supreme Court.
461. Why state decisions should not control United States Supreme Court.
462. When the issue of aid bonds by a city is authorized.
463. When the right to municipal aid is lost by delay in constructing road.
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467. Estoppel of a city to claim that bonds were wrongfully issued.
468. What will not affect the rights of bona fide bondholders.
469. When a purchaser of void municipal bonds cannot maintain an action for money had and received.

§ 459. City aid bonds, generally.— The constitutionality of the general law of Indiana authorizing the donation and issue of bonds in aid of railroad companies, has been regarded as settled by the Indiana Supreme Court.[1] And bonds regularly issued and delivered by the authority of that law, in the hands of a *bona fide* holder, for a valuable consideration, the court held must be regarded as public securities, and placed on a footing with bills of exchange.[2] The power to issue bonds as a simple donation is not included in the general power incident to municipal corporations to issue their bonds for existing indebtedness or for money borrowed for municipal purposes.[3] Without express power in its charter, a city cannot issue bonds in aid of a railroad company

[1] City of Mt. Vernon *v.* Hovey, (1876) 52 Ind. 563; citing Sankey *v.* Terre Haute & S. W. R. R. Co., 42 Ind. 402.

[2] City of Mt. Vernon *v.* Hovey, (1876) 52 Ind. 563; citing City of Aurora *v.* West, 22 Ind. 88; Nugent *v.* The Supervisors, 19 Wall. 241; Moran *v.* The Commissioners of Miami County, 2 Black, 722; Lee County *v.* Rogers, 7 Wall. 181; Mercer County *v.* Hacket, 1 Wall. 83; Rogers *v.* Burlington, 3 Wall. 654; Clark *v.* City of Janesville, 10 Wis. 136; State ex rel. Treadwell *v.* Commissioners, 12 Ohio St. 596; New Albany, etc., Plank Road Co. *v.* Smith, 23 Ind. 353; Board of Commissioners *v.* Bright, 18 Ind. 93. That a municipality may be compelled by *mandamus* to issue its bonds in aid of a railroad company, see Mayor, etc., Kokomo *v.* State, 57 Ind. 152.

[3] Bissell *v.* City of Kankakee, 64 Ill. 249.

as a gratuity, as, for instance, in order to drain swamps, or to secure the location of the workshops of the company in such city.[1] A city being expressly authorized to borrow money to pay for stock subscribed in aid of a railroad company, the power to determine time of payment, and to issue bonds and other evidences of indebtedness, would be implied.[2] Where the proposition submitted to the electors of a city was whether it should issue its bonds in aid of a railroad "to an amount not exceeding one million dollars," and the election resulted in favor of the proposition, the city council would have a discretionary power as to the amount of the bonds to be issued, not exceeding $1,000,000, and may confine the issue to $500,000.[3] Where the petition for a donation of bonds to a railroad company by a city, asks a donation of bonds in a certain amount without interest, the city cannot issue bonds bearing interest.[4] The fact that some members of the council of a city who voted in favor of a donation of its bonds upon a petition in aid of a railroad company, were also officers of the railroad company, has been held not to have disqualified them from acting, or the council from passing an ordinance making the donation.[5] The donation of bonds by a city in aid of a railroad is an absolute grant, and, after it is made, collection of a tax levied to pay interest on, or create a sinking fund to pay the principal of, such bonds can be enjoined only on grounds constituting a valid defense to payment of the bonds in the hands of present holders.[6] Under the General Statutes of Indiana a city might subscribe to stock of a railroad company without petition, and might issue and sell its bonds to borrow money to pay the subscription. A petition from freeholders is only

[1] New Orleans, M. & C. R. Co. *v.* Dunn, 51 Ala. 128. In City of Mt. Vernon *v.* Hovey, (1876) 52 Ind. 563, where the bonds donated in aid of a railroad company by the city had been issued to it after its consolidation with another railroad company, the Supreme Court held that an injunction would not lie in the action of a taxpayer for an injunction to restrain the collection of a tax assessed against him for the payment of the interest on these bonds and to create a sinking fund for the payment of the principal of the bonds, no irregularity in the petition of the freeholders or in the order of the common council making the donation being shown, and no irregularity in the consolidation of the companies being claimed.

[2] E., I. & C. R. R. Co. *v.* City of Evansville, 15 Ind. 395.

[3] Winter *v.* City Council of Montgomery, (1880) 65 Ala. 403.

[4] Mayor, etc., Kokomo *v.* State, 57 Ind. 152. As to interest on coupons of railroad aid bonds, see City of Pekin *v.* Reynolds, 31 Ill. 529.

[5] Mayor, etc., Kokomo *v.* State, 57 Ind. 152.

[6] Wilkinson *v.* City of Peru, 61 Ind. 1.

required in case of donation of city bonds in aid of railroads.[1] Petitioners for aid by way of donation of bonds by the city council of a city in Indiana have been held to have the right to withdraw their names from the petition, by signing a remonstrance, after the petition has reached the council and been referred to a committee. The withdrawal would have the same effect as if they had not signed.[2] Such petitions must accord with the provisions of the statute authorizing them, otherwise they will be invalid.[3] Donation under the act under which the bonds of this city were donated was held to mean an absolute gift or grant without any condition or consideration.[4] When a power to subscribe to stock of a railroad company has been conferred by a petition in the terms of the Indiana statute upon the common council of a city, the mode in which the power should be exercised, in a measure, would be necessarily left to the discretion and judgment of the common council.[5] Where, by its charter, an Indiana city was empowered to subscribe to stock "in any chartered company, for making roads to said city," the Supreme Court of that state held that a road through that city was a road to it within the meaning of its charter.[6] It was held in another case that a "railroad" was such a "road" within the meaning of such a provision in the charter of a city.[7] The receipt of bonds by the railroad company, as cash in payment of such a subscription, would not be beyond the power of either the city or railroad company.[8] Where the charter of an Indiana city provided that the city might, upon compliance with certain formalites, create a debt, and restrained the authorities, in general, to a certain rate of taxation, but at the same time authorized the corporation to construct wharves, docks, piers, water works, works for lighting city, etc., undertakings, the expense of which might far exceed the revenues of the city at the general rate of taxation, the Supreme Court held that the authority to create a debt in that provision of its charter empowered it to create a debt only

[1] Thompson *v.* City of Peru, 29 Ind. 305. See, also, City of Aurora *v.* West, 9 Ind. 74.

[2] Noble *v.* City of Vincennes, 42 Ind. 125.

[3] I., N. & S. Ry. Co. *v.* City of Attica, 56 Ind. 476.

[4] Wilkinson *v.* City of Peru, 61 Ind. 1.

[5] E., I. & C. R. R. Co. *v.* City of Evansville, 15 Ind. 395.

[6] City of Aurora *v.* West, 9 Ind. 74.

[7] E., I. & C. R. R. Co. *v.* City of Evansville, 15 Ind. 395.

[8] Ibid.

for these undertakings, and would not authorize an issue of bonds in aid of a railroad company.[1] A city cannot defeat a subscription in aid of a railroad company by setting up a parol condition inconsistent with the terms of contract of subscription.[2] The ordinary coupon bonds of a municipal corporation having authority to issue them payable to bearer or to the order of a person named, though under seal, are commercial or negotiable instruments on an equality with bank bills or bills of exchange, if, in other respects, they have the essential requisites of negotiable paper.[3] Bonds issued by a city in Alabama, in aid of a railroad corporation, under statutory authority, were held not to be negotiable paper, because on their face they were made payable on a contingency which might never happen, to wit, the completion of the railroad to that city, and also because they were payable to bearer only.[4] The title to these bonds, therefore, it was held could not pass by delivery, nor, as against the real owner, except by his indorsement and assignment.[5] Under an Alabama act authorizing a city to issue aid bonds which was silent as to the kind of currency in which the bonds were to be paid, the Supreme Court held that the city had power to make them payable "in gold coin of the United States of the present standand, weight and fineness."[6] A complaint of fraud in the election on the question of taking stock or issuing bonds must be made in proper time and before any right has accrued under the election.[1] The issuing of the bonds of a municipal corporation to a railroad company being dependent upon the condition that the road of the company should be completed to a certain city within a given time, the Illinois Supreme Court held that the completion of the road to about a mile from the city and an arrangement with another company, the road of which it intersected, that it should run its trains over that other road, should be regarded as a substantial compliance with the condition.[2] Where bonds have been issued by a municipal corporation, regular on their face, negotiable in form, and have passed into the hands of third persons as purchasers for value, who are not charged with knowledge or notice of any iregularity in their issue, taxpayers cannot enjoin the collection of a municipal tax levied to pay the interest on them.[3] A city in Illinois was authorized to subscribe to the capital stock of a railway company upon an affirmative vote of the people, to be paid for in corporate bonds to run not exceeding ten years, and to bear not exceeding ten per cent interest. The proposition submitted and voted was that the bonds to be issued should be made payable in not less than twenty years and bear interest at the rate of eight per cent per annum. This proposition was held to be materially variant from the one authorized by law in respect to the time the bonds had to run before due, and the submission was held to be in excess of the power conferred, and the vote upon it without any binding authority; it

[1] City of La Fayette *v.* Cox, 5 Ind. 38. As to a limitation upon the rate of taxation by a city to pay its bonds issued in aid of a railroad company under power granted in the city's charter, see Burnes *v.* Atchison, 2 Kans. 454. As to the right of a purchaser of city bonds to presume that the necessary steps had been taken for the legal issuance of the bonds of a city in aid of a railroad company, see Atchison *v.* Butcher, 3 Kans. 104. That the collection of taxes and paying interest on bonds of a city in aid of a railroad company will not amount to a ratification of bonds issued without authority, in the absence of legislative authority to ratify, see Atchison *v.* Butcher, 3 Kans. 104. When a vote under article 11, section 14, of the Constitution of Missouri of 1865, would authorize a subscription to the stock of a railroad company, but would not validate the issue of negotiable bonds in payment of the subscription, see Hill *v.* City of Memphis, 134 U. S. 198; s. c., 10 Sup. Ct. Rep. 562. What defense is not open to a city in an action by a railroad company to recover money voted to it by the city and payable when the road is completed for use, see Manchester & Keene Railroad *v.* City of Keene, 62 N. H. 81.

[2] Evansville, etc., R. R. Co. *v.* City of Evansville, 15 Ind. 395.

[3] Blackman *v.* Lehman, 63 Ala. 547; Colt *v.* Barnes, 64 Ala. 108; State *v.* Cobb, 64 Ala. 127; Reid *v.* Bank of Mobile, 70 Ala. 199; Gilman *v.* N. O. & S. R. R. Co., 72 Ala. 566.

[4] Blackman *v.* Lehman, 63 Ala. 547.

[5] Ibid.

[6] Judson *v.* City of Bessemer, 87 Ala. 240; s. c., 6 So. Rep. 267. As to the power of cities to extend aid to railroad corporations, see Bard *v.* City of Augusta, 30 Fed. Rep. 906; Bartemeyer *v.* Rohlfs, (Iowa) 32 N. W. Rep. 673; Perrin *v.* City of New London, (Wis.) 30 N. W. Rep. 623. City bonds in payment of a subscription to stock of a railroad company held unauthorized in Katzenberger *v.* City of Aberdeen, 7 Sup. Ct. Rep. 947. As to the effect of noncompliance on the part of a railroad corporation with the conditions connected with its use of part of the public domain of a city under a grant of the same by statute, and the assent of the city authorities, see City of Macon *v.* East Tennessee, Virginia & Georgia Ry. Co., 82 Ga. 501; s. c., 9 S. E. Rep. 1127.

[1] Robertson *v.* City of Rockford, 21 Ill. 451; Johnson *v.* Stark County, 24 Ill. 75; Perkins *v.* Lewis, 24 Ill. 208; Butler *v.* Dunham, 27 Ill. 474.

[2] People *v.* Holden, 82 Ill. 93.

[3] State ex rel. Stow *v.* City Council of Montgomery, (1883) 74 Ala. 226. In Hunt *v.* Fawcett et al., County Commissioners, (Wash. 1894) 36 Pac. Rep. 318, the Supreme Court held, in a taxpayer's action against the commissioners, that he was entitled to an injunction to restrain them from issuing certain bonds, as the debt proposed to

was also held that the issue of the bonds voted could not be compelled by the courts.[1] A municipal corporation that has lawfully contracted a debt for legitimate purposes has been held, by a majority of the Pennsylvania Supreme Court, to have power, unless restricted by its charter, or prohibited by statute, to issue its bonds in payment of the debt; further, that such power was not restricted by a special statute authorizing the corporation to borrow money from time to time, for city purposes, as might be required, not exceeding a certain amount, and issue bonds therefor.[2] There is included in the power to subscribe to the stock of a railroad company a power to contract a debt for that purpose; a city may, therefore, issue its bonds for such a subscription.[3] A

be incurred was beyond the limitation of indebtedness allowed the corporation to incur and had not been properly ratified or validated, and further the arrangement with a trust company for the sale of the bonds by which the latter was to be allowed commissions, etc., of a large amount, violated the requirement of law that they should not sell them below par.

[1] Cairo & St. Louis R. R. Co. *v.* City of Sparta, 77 Ill. 505. Where a statute of Tennessee was held not to authorize an election for bonds in aid of a railroad corporation, or the issue of the bonds by the city, and the bonds were held not enforceable by the holders. Norton *v.* Taxing District of Brownsville, 129 U. S. 479; s. c., 9 Sup. Ct. Rep. 322. Where it was held that a judgment by the holder upon some of the bonds did not estop the city from claiming that the statute authorizing them had been abrogated by the constitutional amendment of 1870. Taxing District of Brownsville *v.* League, 129 U. S. 493; s. c., 9 Sup. Ct. Rep. 327, holding that the bondholder was not entitled to a *mandamus* to compel a levy of taxes to pay his judgments. Bonds of a city in Illinois held to be invalid by reason of non-completion of the road of the railroad company, in aid of which they were voted and issued, in time, in Eddy *v.* People, 127 Ill. 428; s. c., 20 N. E. Rep. 83. Where municipal bonds in aid of a railroad have been held void under the Constitution of Illinois of 1870. Casey *v.* People, (Ill.) 24 N. E. Rep. 570. Where a statute of Missouri providing for the funding of debts of incorporated towns and empowering them to issue their bonds in payment of such indebtedness, but providing for no vote as a prerequisite to their issue, was held in contravention of the Constitution of the state of 1865, article 11, section 14. Hill *v.* City of Memphis, 134 U. S. 198; s. c., 10 Sup. Ct. Rep. 562.

[2] City *v.* Commonwealth, 84 Pa. St. 487; s. c., 4 W. N. C. (Pa.) 385.

[3] Commonwealth *v.* Pittsburgh, 41 Pa. St. 278; Commonwealth *v.* Comrs. of Allegheny, 43 Pa. St. 400. As to power in municipal corporations to borrow money, implying power to issue its bonds therefor, see Bunch's Exr. *v.* Fluvanna County, (1890) 86 Va. 452; Rogers *v.* Burlington, 3 Wall. 654; Seybert *v.* Pittsburg, 1 Wall. 272; Middleton *v.* Allegheny County, 37 Pa. St. 241. See, as to the power of the legislature of Iowa to authorize a city to subscribe for and take stock in a railway company, to issue its bonds therefor, and to lay a

municipal subscription to the stock of a railroad company would not be invalidated by a change of termini of the road in the power of the railroad company to make.[1] Should a subscription in aid of a railroad company be authorized, on conditions subsequent, the issuing of bonds in payment of the subscription by the municipality would be evidence either of performance of the conditions by the railroad company or a waiver of the conditions by the municipality.[2] Where a municipality has provided funds to meet the interest on its bonds at maturity, it will not be liable for interest on the bonds, after maturity.[3] City officers have been held to have been properly enjoined from selling bonds of the city below par, under the guise of allowing commissions upon the sales, in Pennsylvania.[4]

§ 460. Rules as to such bonds settled in United States Snpreme Court.—"The following propositions," Mr. Justice HUNT of the Supreme Court of the United States, in an opinion rendered by him, has said, "may be considered as settled in this court: (1) If an election or other fact is required to authorize the issue of the bonds of a municipal corporation, and if the result of that election or the existence of that fact is by law to be ascertained and declared by any judge, officer or tribunal, and that judge, officer or tribunal, on behalf of the

tax to pay the interest thereon, as also its power to give validity to bonds as formally issued for such purposes, Rogers *v.* Keokuk, 154 U. S. 546, following Gelpcke *v.* Dubuque, 1 Wall. 175. See Rogers *v.* Lee County, 154 U. S. 547. See a note, 1 Atl. Rep. 109, as to power to issue municipal bonds and the rights of *bona fide* holders.

[1] Commonwealth *v.* Pittsburgh, 41 Pa. St. 278.

[2] Commonwealth *v.* Pittsburgh, 43 Pa. St. 391. That the holders of old bonds of a municipal corporation cannot be compelled to receive the new bonds authorized by a statute to be issued for the redemption of the old ones, at a premium which the new bonds may command in the market, see Lloyd *v.* City, 134 Pa. St. 545.

[3] Friend *v.* City, 131 Pa. St. 305. That interest is recoverable on coupons after payment of the coupons is unjustly rejected and refused, see Mills *v.* Jefferson, 20 Wis. 50; Aurora City *v.* West, 7 Wall. 82; North Penn. Railroad *v.* Adams, 54 Pa. St. 94; San Antonio *v.* Lane, 32 Tex. 405; Brainerd *v.* New York & Harlem R. R. Co., 25 N. Y. 496; Connecticut Mut. Life Ins. Co. *v.* Cleveland, etc., R. R. Co., 41 Barb. 9; New Albany Plank Road Co. *v.* Smith, 23 Ind. 353; Morris Canal & Bkg. Co. *v.* Lewis, 12 N. J. Eq. 323. As to the power of municipalities to contract to pay interest on their bonds, free from taxes, see Trust Co. *v.* City, 102 Pa. St. 387.

[4] Whelen's Appeal, 108 Pa. St. 162.

corporation, executes or issues the bonds, with a recital that the election has been held, or that the fact exists, or has taken place, this will be sufficient evidence of the fact to all *bona fide* holders of the bonds. (2) If there be lawful authority for the municipality to issue its bonds, the omission of formalities and ceremonies, or the existence of fraud on the part of the agents of the municipality issuing the bonds, cannot be urged against a *bona fide* holder seeking to enforce them.[1] (3) There must, however, be an original authority by statute to the municipality to issue the bonds. Municipal corporations have not the power, except through the special authority of the legislature, to issue corporate bonds which will bind their towns; neither have they the power to sell or mortgage the lands belonging to such towns without special authority.[2]

§ 461. Why state decisions should not control United States Supreme Court.— There was testimony on the trial of this case tending to prove that a registration had been made of the qualified voters of the county, and that it showed over 1,000 such voters. The vote cast at the election, upon the question of subscription of bonds in aid of the railroad company, was for the subscription, 510, and against, 98; that is, more than two-thirds of those who actually voted assented to the subscription, but not two-thirds of the qualified voters as shown by the registration. Several decisions of the Supreme Court of Missouri, the state in which was the county making the subscription and issuing the bonds, were cited to the Supreme Court of the United States, the latest being that of State *v.* Harris, 96 Mo. 29, in which that court had held that two-thirds of those actually voting was not sufficient, and that it must appear that two-thirds of the qualified voters, as ascertained by the registration, assented to the subscription, and it was said that the Supreme Court of the United States should follow the settled construction placed upon its statutes by the Supreme Court of the state. To this Mr. Justice BREWER, for the United States Supreme Court, said: "This question has been thoroughly discussed in this court, and it is

[1] Citing Grand Chute *v.* Winegar, 15 Wall. 355; Commissioners of Knox County *v.* Aspinwall, 21 How. 539; Gelpcke *v.* Dubuque, 1 Wall. 203; Moran *v.* Miami County, 2 Black, 722.

[2] Kenicott *v.* Supervisors, (1872) 16 Wall. 452, 464, 465; citing, on last proposition, Marsh *v.* Fulton County, 10 Wall. 676.

unnecessary to enter into a re-examination of it. These decisions [from Missouri] were made after the issue of the bonds, and cannot be deemed controlling."[1] The Supreme Court of the United States, in a case before it involving the validity of an act of the legislature of Wisconsin, were urged that the court was bound by a decision of the state Supreme Court that this act was unconstitutional, reported as Whiting *v.* Fond du Lac Company, 25 Wis. 188. The court declared these general principles that it would follow, as of obligation, the decisions of the state courts only on local questions peculiar to themselves, or on questions respecting the construction of their own Constitution and laws; that whether or not the construction and maintenance of a railroad owned by a corporation, and constructed and maintained under a statute of a state authorizing such construction and maintenance, is a matter in which the public has any interest of such a nature as to warrant taxation by a municipal division of the state in aid of it, is not such a question. It is one of general law. If a contract when made was valid under the Constitution and laws of a state, as they had been previously expounded by its judicial tribunals, and as they were understood at the time, no subsequent action by the legislature or the judiciary will be regarded by this court as establishing its invalidity. A railroad is a public highway. Being so, and thus a road of public use, a state may impose a tax in furtherance of that use, even though the road itself be built and owned by a private corporation. These principles they then applied to the case at bar, and held the act of the legislature of Wisconsin, authorizing a vote of the people of this particular county upon the question whether they would aid the building of a certain railroad, and if they voted in favor of aiding, authorizing the issue of county orders for money to aid in the building, to have been a proper exercise of legislative authority, and the county charged on orders issued by it and given to the road by way of donation.[2]

[1] Knox County *v.* Ninth National Bank, (1893) 147 U. S. 91, 99; citing Cass County *v.* Johnston, 95 U. S. 360; Daviess County *v.* Huidekoper, 98 U. S. 98; Douglass *v.* Pike County, 101 U. S. 677; Carroll County *v.* Smith, 111 U. S. 556.

[2] Olcott *v.* Supervisors, (1872) 16 Wall. 678. The cases cited and most of them reviewed were: Havemeyer *v.* Iowa City, 3 Wall. 294; Gelpcke *v.* City of Dubuque, 1 Wall. 175; Ohio Life & Trust Company *v.* Debolt, 16 How. 432; Pratt *v.* Brown, 3 Wis. 612; Robbins *v.* Railroad Company, 6 Wis. 641; Hasbrouck *v.* Milwaukee, 13 Wis. 37; Soens *v.* Racine, 10 Wis. 280; Brodhead *v.* Milwaukee, 19 Wis.

§ 462. When the issue of aid bonds by a city is authorized. —The city council of an Illinois city, in conformity with a vote of the people at an election which had been authorized by a resolution of that body previously, passed an ordinance empowering and directing the mayor to subscribe a specified amount, payable in city bonds, to the capital stock of a railroad company, a Missouri corporation, which was to run its road into the Illinois city, the issue and payment of the bonds conditioned upon a certain expenditure in a certain way by the corporation, with a guaranty that the proceeds of the bonds should be expended in that manner. The next day the subscription was made by the mayor. Afterwards, the general assembly of Illinois, by act, legalized and confirmed the action of the city council in ordering the vote and in all respects whatever relating to this transaction. A part of the bonds were delivered at one time and the balance later after a change of the Constitution of the state, negotiable in form and payable to the order of the railroad company or bearer, at a certain bank in New York city, they purporting to have been issued under and by virtue of the ordinance first passed and of the act of the legislature legalizing and confirming the action of the council. In an action upon coupons taken from some of the bonds first delivered, to recover the amount due upon the coupons, the findings of the court were that all the bonds from which the coupons were detached had been purchased for value before maturity, in open market in the usual course of business and without notice of any infirmity therein; that the conditions on the part of the railroad company had been complied with, and that the city, for six years after issuing the bonds, had paid the interest upon the bonds, and by its agent in meetings of the corporation had voted upon its stock. In the action the validity of the bonds was brought in question. The Supreme Court of the United States held that the authority of the city to issue these bonds was not determinable by the provisions of the Constitution of 1870, which — saving municipal subscriptions made under existing laws by a popular vote prior to its adoption — declared

652; Clark *v.* Janesville, 10 Wis. 136; Bushnell *v.* Beloit, 10 Wis. 195; Beekman *v.* Saratoga & Schenectady R. R. Co., 3 Paige, 45; Bloodgood *v.* Mohawk & Hudson R. R. Co., 18 Wend. 1; Worcester *v.* Railroad Company, 4 Met. 564; Charles River Bridge *v.* Warren Bridge, 7 Pick. 495; Gibbons *v.* Mobile & Great Northern R. R. Co., 36 Ala. 410.

that "No county, city, town, township or other municipality shall ever become subscriber to the capital stock of any railroad or private corporation or make donation to or loan its credit in aid of such corporation: *Provided, however*, that the adoption of this article shall not be construed as affecting the rights of any such municipality to make such subscriptions when the same have been authorized, under existing laws, by a vote of the people of such municipalities prior to such adoption." "This is quite clear," it is said in the opinion rendered, "in view of section 24 of the schedule of that Constitution, which provides: 'Nothing contained in this Constitution shall be so construed as to deprive the general assembly of the power to authorize the city of Quincy to create any indebtedness for railroad or municipal purposes, for which the people of said city shall have voted, and to which they shall have given by such vote their assent prior to [a certain date]'" with some provisions.[1]

[1] Quincy *v.* Cooke, (1882) 107 U. S. 549. Mr. Justice HARLAN, in the opinion, then referred to an Illinois decision as follows: "The Supreme Court of Illinois, in Q., M. & P. R. R. Co. *v.* Morris, 84 Ill. 410, had occasion to consider the scope and effect of that section. In that case an election was held August 7, 1869, under the authority of a resolution of the city council, to take the sense of the people upon a subscription to the capital stock of the Quincy, Missouri and Pacific Railroad Company, also a Missouri corporation, whose road lay wholly within that state. That election was held without any law authorizing a vote on the question, or empowering the city to become a stockholder in that company. But, by an act passed July 1, 1871, after the Constitution of 1870 went into operation, the city of Quincy, subject to the terms and requirements embodied in the proposition submitted to the people, was authorized to make, upon such conditions as the city council deemed best, a subscription to the stock of that company, for which the people may have voted prior to the thirteenth day of December, 1869. The act further provided: 'Any election held in said city prior to said day, for the purpose of such vote being taken, and any contract or subscription made, or to be made, by said city to the capital stock of said railroad company in pursuance thereof, and any bonds or other evidences of such indebtedness issued or to be issued by said city are hereby declared valid.' Under that act the subscription was made and bonds issued, and the controlling question was as to their validity. The court, waiving any expression of opinion as to the validity of that part of the act which in terms purported to legalize the election, decided: That the obvious effect and intent of the twenty-fourth section of the schedule of the Constitution were to leave the action of the city of Quincy in assuming by vote prior to December 13, 1869, to create indebtedness for a railroad subscription and the power of the legislature over it, 'unaffected by the Constitution of 1870; in other words, to leave the vote and the power of the legislature to confer the right to take stock precisely as they would have been under the Constitution of 1848;'

§ 463. When the right to municipal aid is lost by delay in constructing road.— A special law empowering a municipal corporation of Minnesota to issue its bonds in aid of the construction of a railroad provided for a popular vote upon the proposition to issue bonds; that the proposal to be voted on should designate *the period within which the road must be built in order to entitle it to the benefit of the bonds;* that the bonds when voted should be delivered "in escrow" to designated persons as commissioners, to be by them delivered to the railroad company upon full and complete compliance with the terms of the act; and that if the company should fail to comply with such conditions it should be the duty of such commissioners to *forthwith* return the bonds to the city council. Such a proposal, fixing the first of November as the time within which a railroad should be completed into the city ready for operation, was submitted to the people, and the vote was in favor of issuing the bonds. The road was to be built partly across the right of way of another company, and the latter had it enjoined from crossing. From this came delay, and the road of the company which was to be aided by the bonds was not completed and in full operation until the fifteenth of November. Certain taxpayers of the city brought an action to restrain the commissioners holding the bonds from delivering them to the railroad company, and they were by judgment of the court perpetually enjoined. The case was appealed to the Supreme Court of the state, and that court held that the completion of the road by the time specified was a condition precedent, and that by reason of the failure of the company to comply therewith it was not entitled to the bonds.[1]

that the city council were the corporate authorities of Quincy, upon whom, within the meaning of the Constitution of 1848, the legislature could confer, without the intervention of a popular vote, authority to make the subscription and issue the bonds; that section 24 of that schedule embraced a vote taken without authority of law prior to December 13, 1869, because, had the vote been legal, the language 'for which the people of said city shall have voted, and to which they shall have given, by such vote, their assent,' would have been unnecessary in view of the proviso in the general section forbidding municipal subscriptions in aid of railroad corporations; lastly, that the construction of the Quincy, Missouri and Pacific railroad, although no part of it lay in Illinois, was a corporate purpose of the city of Quincy, because thereby its trade and commerce were increased, its property enhanced in value and its welfare promoted."

[1] McManus *v.* Duluth, Crookston & Northern R. Co., (1892) 51 Minn. 30; s. c., 52 N. W. Rep. 980. *Arguendo*, the court said: "While the provisions

§ 464. The election as to aid and the effect of curative legislation.— The power of the city to issue the bonds involved in this case was denied upon these principal grounds: 1. That the election held under the sanction of the city council, and the action of that body in directing the subscription to be made were of no legal effect, since the election was held without authority of law, and other subscriptions were made when there was no legislative authority to create such indebtedness. 2. That with-

of the special act constituted a part of the proposal of the railroad company, and of the petition upon which the vote was taken, it was more than a mere term or element in a contract. It was a *law* controlling the action of the city. The municipality had only such power as was conferred by this act to issue bonds in aid of this undertaking. Whatever conditions the law imposed, relating to the exercise of this power, must be complied with. The power conferred by the legislature is not to be extended, nor the express conditions restricted, by doubtful construction. Dill. Mun. Corp. 90, 91." The court, construing the act, further said: "The period for construction, under the act referred to, cannot be regarded as unessential and as not intended to be strictly complied with without disregarding language, the plain, natural import of which is to the contrary, or at least without a free, liberal construction in favor of those claiming under the power, contrary to the rule of construction in such cases. In the significant language which we have recited there is little room for construction or for doubt as to the meaning. '*The period within which said road must be built, * * * in order to entitle said railroad to the benefit of the bonds,*' was required to be and was stated in the petition or proposal upon which the people voted. It was required to be, and was, one of the conditions of the contract thus entered into. The ordinary, natural import of the language is that '*in order to entitle said railroad company*' to the bonds voted it '*must*' construct the road within the period of time stated. Further provisions of the law, above recited, make even more clear the correctness of this construction. As has just been said, this provision as to the time for construction was certainly one of the conditions or terms upon which the bonds were to be, and were voted. It is one of the 'conditions' afterwards referred to in the act, where it is said that if the company shall 'fail to comply with such conditions' it shall be the duty of the commissioners to '*forthwith*' return the bonds to the city council, which is as much as to say that they are not to be delivered to the railroad company. It may be added that the proposal of the railroad company, which was incorporated in the petition for the election, and upon which the bonds were voted, was 'to build and complete ready for operation, by or before November 1, 1889.' In support of the conclusion that the provision in the law and in the contract, as to the time within which the road should be constructed, was in the nature of a condition precedent, and that by reason of its failure to comply with that requirement the railroad is not entitled to the bonds, may be cited Bohn Mfg. Co. *v.* Lewis, 45 Minn. 164; s. c., 47 N. W. Rep. 652; Winona *v.* Minnesota Ry. Const. Co., 27 Minn. 415; s. c., 6 N.

out such authority no subscription could be legally made. 3. That the curative act of March 27, 1869 [legalizing the bonds, etc.], was invalid, because it assumed to impose indebtedness upon the city without the consent of its corporate authorities. The Supreme Court of the United States held that the corporate authorities of the city, after the passage of the act legalizing the bonds, had authority to issue them.[1]

W. Rep. 795, and 8 N. W. Rep. 148; Hodgman *v.* Chicago & St. P. Ry. Co., 20 Minn. 48; Memphis, K. & C. Ry. Co. *v.* Thompson, 24 Kans. 170; Falconer *v.* Buffalo & J. R. Co., 69 N. Y. 491; Portland & O. C. R. Co. *v.* Inhabitants, etc., of Hartford, 58 Me. 23; Eddy *v.* People, 127 Ill. 428; s. c., 20 N. E. Rep. 83."

[1] Quincy *v.* Cooke, 107 U. S. 549. It was said by the court: "In support of the position taken by the city, counsel refer to numerous decisions of the Supreme Court of Illinois, construing the [section] of the Constitution of 1848 which provides that 'the corporate authorities of counties, townships, school districts, cities, towns and villages may be vested with power to assess and collect taxes for corporate purposes.' From those decisions the following propositions, among others, may be deduced: That the clause was intended to define as well the class of municipal officers upon whom the power of taxation, for local purposes, might be conferred, as the purposes for which such power could be constitutionally exercised; that by the phrase 'corporate authorities' must be understood those municipal officers who were selected with some reference to the creation of municipal indebtedness, and who were either directly elected by the population to be taxed, or appointed in some mode to which they have given their assent; that the construction of a railroad, at least one within or near a county, township, town, village or city, was a corporate purpose of such municipality, and that a debt for a subscription to the stock of a railroad corporation, or for bonds in payment thereof, could not be imposed upon a municipal corporation without the consent or against the will of its corporate authorities. But it has been quite as distinctly ruled by the Supreme Court of Illinois that the city council, and not the voters of an incorporated city, were its corporate authorities within the meaning of the Constitution of 1848, and if empowered by legislative enactment could, under that instrument, subscribe to the stock of a railroad corporation, and issue bonds in payment thereof, without submitting the matter to popular vote. Such was the decision in Q., M. & P. R. R. Co. *v.* Morris, 84 Ill. 410, where the court reaffirmed the ruling upon this point in Keithsburg *v.* Frick, 34 Ill. 405, 421. In the latter case a subscription made by a town to the capital stock of a railroad corporation — without authority of law, as was alleged — was, by an act passed after the town was incorporated under a special charter, declared to be legal, and bonds authorized to be issued therefor. The court said: 'It is by no means a necessary element in these subscriptions that there should be a vote of the inhabitants of the town or city authorizing them. It is competent for the legislature to bestow the power directly on the corporation without any intermediary, as they did in this case.' In

§ 465. This case distinguished from others.— The court distinguished this case as follows: "This case is clearly distinguishable from those in which the legislature has attempted to impose upon a municipal corporation, without the consent of its corporate authorities, an indebtedness for subscription to the corporate stock of a railroad corporation. The cases mainly relied on by counsel for the city are those in which certain officers of limited authority were, in terms or in effect, required by legislative enactment to issue bonds or incur indebtedness in the name of a municipality, without the consent, expressed in legal form, of those who were, in the constitutional sense, its corporate authorities. Here there can be no question but that the city council are the corporate authorities of Quincy. And there is no ground whatever upon which to rest the suggestion that the indebtedness was created without their consent. In no just sense were they compelled to issue bonds in exchange for stock in the railroad company. If, as claimed by the city, the act of March 27, 1869, was inoperative in so far as it assumed to legalize and confirm what had been previously done without the sanction of law, nevertheless by that act it was intended to confer upon the city council power, in execution of the expressed will of the

Marshall *v.* Silliman, 61 Ill. 218, 225, the right of the legislature to grant such an authority to the trustees of an incorporated town was conceded. And in Williams *v.* Town of Roberts, 88 Ill. 11, 21, the court, speaking by Scholfield, Ch. J., said: 'County boards, such as boards of supervisors, county commissioners, etc., and the municipal authorities of incorporated cities, towns and villages, may, when empowered so to do by proper legislation, subscribe for the stock of railroad corporations without first submitting the question to the electors of the municipality. They are elected as representatives of the electors, and theoretically, in appropriate cases, their acts are the acts of those they represent. Hence it has been held where a vote of the electors has been required as a precedent condition to the making of a subscription for stock in a railroad company, and the law prescribing the mode of calling and holding the election has not been observed, inasmuch as the legislature might have empowered the municipal authorities to make the subscription without first submitting the question to the electors, it may, by a subsequent enactment, declare the non-compliance with the law in the holding of the election of no consequence, and validate the subscription, in other words, validate the subscription without reference to the election. This, however, it will be observed, is upon the theory that power to make the subscription does not in any degree necessarily depend upon a vote of the electors of the municipality upon that question, but solely upon the will of the legislature.' The authorities to which we have referred sustain the judgment against the city."

voters, to issue bonds to the amount of $100,000 for stock in this railroad company. The vote of the electors, we have seen, was not essential to the validity of bonds issued, under legislative sanction, by the corporate authorities of the city. The city council was not required and directed, but only empowered, to proceed as if they had been originally invested with authority to make the subscription. The legislature, in substance, declared, as it might constitutionally have done, that the corporate authorities of the city had its consent to issue bonds to be exchanged for stock in the railroad company. If the corporate authorities could have been compelled by legal proceedings to issue the bonds, that is only another form of saying that the curative act was constitutional, and, consequently, that the bonds are valid. If, however, they could not have been so compelled, then the execution and delivery of the bonds, under the authority of the act of March 27, 1869, was a voluntary creation of indebtedness for a corporate purpose by the corporate authorities of the city."[1]

§ 466. Aid to railroad outside the state.— The question was raised in an Illinois case whether a subscription by a city of that state to the stock of a railroad lying wholly in the state of Missouri, was authorized as being for a corporate purpose. The Supreme Court held that the debt was legally created for a corporate purpose.[2]

§ 467. Estoppel of a city to claim that bonds were improperly issued.—Bonds of a city of Mississippi, which had been donated to a consolidated railroad company by authority of an act of the legislature of that state, the preliminary vote as

[1] Quincy *v.* Cooke, (1882) 107 U. S. 549, 555, 556.

[2] Quincy, Missouri & Pacific R. R. Co. *v.* Morris, (1877) 84 Ill. 411. That cities or counties of one state may aid in the construction of a railroad that lies in another state, see Railroad Company *v.* County of Otoe, 16 Wall. 667; Walker *v.* Cincinnati, 21 Ohio St. 14; McCallie *v.* Mayor, etc., 3 Head, 317; St. Joseph & Denver R. R. Co. *v.* Buchanan County, 39 Mo. 485; Bell *v.* Railroad Co., 4 Wall. 598; Copes *v.* Charleston, 10 Rich. (S. C.) 491; Stein *v.* Mobile, 24 Ala. 591. The same principle recognized in Sharpless *v.* Mayor, etc., 21 Pa. St. 147; Gelpcke *v.* Dubuque, 1 Wall. 175; Goddin *v.* Crump, 8 Leigh, 120. That subscriptions to stock of railroads on the part of cities or other municipal corporations, may be authorized by the legislature, and that such subscriptions are for a "corporate purpose," as construed in Illinois, see Prettyman *v.* Tazewell County, 19 Ill. 406; Johnson *v.* Stark County, 24 Ill. 88; Taylor *v.* Thompson, 42 Ill. 9; Chicago, Danville & Vincennes R. R. Co. *v.* Smith, 62 Ill. 268.

required by statute and other conditions having been complied with as determined by the city authorities for another company, which became a part of the consolidated company, a federal court held were legally issued to the latter. The city authorities, in an action upon overdue coupons upon some of the bonds, were held to be estopped, as against an innocent purchaser, having issued and delivered the bonds with proper recitals, from alleging that they acted wrongfully.[1] Neither could they set up as a defense that the consolidated company was authorized to build a different road from the one originally chartered, and to leave such city off its line entirely.[2]

§ 468. What will not affect the rights of bona fide bondholders.—In one of the most recent cases before the Supreme Court of the United States, involving the right of *bona fide* holders of the bonds of a municipal corporation, a city, which bonds were issued in payment of a subscription to stock of a railroad company in accordance with the laws of Illinois prior to the adoption of the Constitution of 1870, the restrictions of this Constitution as to donations of municipal corporations was invoked to prevent a recovery upon the coupons attached to some of those bonds upon which an action was brought by such a holder. It appeared that the bonds, in accordance with regular proceedings of the city council, were executed and delivered after certain agreements had been entered into between the city and the railroad company, in exchange for the same amount of its shares of stock which had been subscribed for by the city, and that afterwards the city had sold this stock to the company, the company returning as a consideration for the same $5,000 of the bonds of the city. This, it was contended, made, as a resultant fact, the transaction a donation of $95,000 of the bonds to the company, such a donation as was prohibited by the State Constitution of 1870. The court held that if the disposition of the stock made

[1] Denison *v.* Mayor, etc., of City of Columbus, (1894) 62 Fed. Rep. 775; citing Block *v.* Commissioners, 99 U. S. 686; Commissioners *v.* January, 94 U. S. 202; Commissioners *v.* Clark, 94 U. S. 278; Brooklyn *v.* Insurance Co., 99 U. S. 362; Moran *v.* Commissioners, 2 Black, 722.

[2] Denison *v.* Mayor, etc., of City of Columbus, (1894) 62 Fed. Rep. 775. The court said: "The rule is that, if bonds are voted to a railroad company which at that time is authorized to consolidate with other railroads, then the bonds may properly be delivered to the consolidated company." Citing Livingston County *v.* First Nat. Bank, 123 U. S. 102; s. c., 9 Sup. Ct. Rep. 18, as announcing the doctrine and reviewing the authorities.

by the city authorities was even wrong the validity of the bonds was not affected thereby; neither could such wrong, if it was a wrong, be presented as a defense against one who had purchased in good faith the bonds thus issued.[1]

§ 469. When a purchaser of void municipal bond cannot maintain an action for money had and received.— The bonds

[1] Cairo *v.* Zane, (1893) 149 U. S. 122. Mr. Justice BREWER, speaking for the court, said: "In the case of Anderson County Commissioners *v.* Beal, 113 U. S. 227, it appeared that after the bonds had been voted by the county, at an election held on September 13, 1869, the county board, on November 5, passed an order directing a subscription in accordance with the terms of the vote, and also 'that the stock above subscribed for by this board in behalf of Anderson county is hereby sold and transferred for and in consideration of the sum of one dollar, the receipt whereof is hereby acknowledged, to James F. Joy, president of said railroad company, and the chairman of this board is authorized to sign a transfer of said stock to said James F. Joy, and to assign the certificate for said stock issued to Anderson county by said railroad company, and to authorize in such assignment the necessary transfer of said stock on the books of said company.' And it was averred that the transfer thus ordered was for the benefit of the railroad company. In reference to this, Mr. Justice BLATCHFORD, speaking for the court, observed (p. 240): 'When the bonds were delivered to the company the transaction was complete, and the bonds, as they afterwards passed to *bona fide* holders, passed free from any impairment by reason of any dealing by the board with the stock subscribed for to which the county became entitled by the issuing and delivering of the bonds. The board may have committed an improper act in parting with the stock, but that is no concern of a *bona fide* holder of the bonds or coupons.' And in Maxey *v.* Williamson County, 72 Ill. 207, it appeared, as here, that after an election authorizing a subscription of one hundred thousand dollars to the stock of a railroad company, the County Court entered into an agreement to sell the one hundred thousand dollars of stock to the railroad company for five thousand dollars, a transaction, it will be perceived, precisely like the one before us. The validity of the bonds thus issued in payment of this subscription was thereafter challenged in a suit by taxpayers to restrain the collection of taxes levied to pay the interest thereon. Their validity was sustained, and in respect to this transfer of the stock the court, on page 212, says: 'We fail to perceive how the sale of the certificate of stock to the company for five thousand dollars can in any manner affect the rights of the holders of the bonds of the county. It surely is not intended to be insisted that because the county has, by any means, lost the consideration it received for the bonds innocent holders who had nothing whatever to do with the sale of the certificate must lose their bonds.' It is said that a different rule has since been established in Illinois, and the cases of Choisser *v.* The People, 140 Ill. 21, and of Post *v.* Pulaski County, decided by the Circuit Court of Appeals for the seventh circuit (9 U. S. App. 1), are cited. But even if this were so, it was not established until long after the plaintiff had purchased these bonds, and he would doubtless be entitled to claim the benefit of the rule existing when

of the city sued here being void because issued under an act which violated the constitutional provision in Missouri declaring that the general assembly shall not authorize any city to loan its credit to any corporation unless two-thirds of the qualified voters assent thereto, it was held by the federal court that the purchaser

he made his purchase; and the facts as they appear in these two cases are substantially unlike those in the case before us. Thus, in Choisser *v.* The People, the vote to subscribe one hundred thousand dollars of stock was on October 5, 1867, and on November 28, following, an agreement was entered into between the company and the County Court, acting on behalf of the county, that one hundred thousand dollars in stock should be issued, but that the stock should be returned back to the company for the sum of five thousand dollars, payable on the redelivery to the city of that amount of county bonds. When the bonds came to be issued the record made by the County Court recited that the one hundred thousand dollars of the capital stock should be sold back to the county for five thousand dollars of county bonds, 'thereby making a payment of ninety-five thousand dollars of Saline county bonds to said company as a donation.' And no stock was in fact issued by the company, or received by the county, or delivered to the company. In short, the parties to the transaction treated it as though it was a donation of ninety-five thousand dollars of bonds, and it was this transaction which was condemned as unauthorized by a vote prior to the Constitution. Yet, even in that case, the court was careful to limit its decision to a case in which only the rights of the railroad company, the party receiving the ninety-five thousand dollars of bonds, were concerned, for it says: 'The only presumption arising from these facts is that said bonds are still in the hands of the railroad company, and no question, therefore, is presented as to how far the alleged invalidity of said bonds would be affected by those conclusive presumptions which the law raises for the protection of *bona fide* holders of commercial paper, * * * nothing is before us except the mere question of the legality of these bonds as between the county and the railroad company, the original parties thereto.' And the case in the Circuit Court of Appeals is simply a counterpart of the case in the Supreme Court. But the case before us is entirely different. The parties did not treat it as a donation. The city issued the full amount of one hundred thousand dollars in bonds, and the company issued a certificate for one hundred thousand dollars of stock, and until the receipt of this certificate no sale had been made of it. All that the record shows was an agreement on the part of the city to sell at a named price. Nowhere is it shown that the company agreed absolutely to purchase. It was, until after the receipt of the stock, an unaccepted offer on the part of the city. No contract was signed by the company. * * * So far as is disclosed, when the trustee delivered the one hundred thousand dollars in bonds and received the one hundred thousand dollars in stock, there was nothing creating any obligation on the company to repurchase its stock, or to return to the city any portion of the bonds. The city had offered to sell, but it had not agreed to buy. It could have stopped with the receipt of the one hundred thousand dollars of bonds, and left the city to do what it pleased with the stock. There is, therefore, not presented the case of an ignoring of the fact or terms of a

could not maintain an action for money had and received to recover the amount paid to the city for such bonds, as the city having no power to create the debt, no implied promise could arise for its payment, notwithstanding the general statute of Missouri which gives the board of trustees power "to borrow money for the improvement" of the town, the money having been borrowed in violation of the Constitution, and not for the improvement of the town, but to buy a right of way and depot grounds for a railroad.[1]

subscription. Everything authorized by the vote of the people was done, and fully done, and whatever wrong may have been committed by the city council in its proffer of sale and subsequent sale of the stock could not vitiate the bonds after they had passed into the hands of a *bona fide* holder. But, further, the bonds on their face show that they were issued in payment of stock in the railroad company, and recite that they were issued in pursuance of an ordinance of the city council, and authorized by a vote of the citizens and in accordance with the laws of the state; and these were duly registered by the auditor of the state, and his certificate of registry was indorsed on the back. It is true that the recitals do not show when the ordinance was passed or the election held, and do not refer by title or otherwise to the particular statute granting the authority, and the bonds were dated and issued after the Constitution of 1870 had come into force. It is also true that the certificate of registry is not conclusive that the bonds were issued in full compliance with the terms and conditions of a subscription. German Savings Bank *v.* Franklin County, 128 U. S. 526, 540. But surely these recitals and this certificate have significance. It is unnecessary to affirm that the certificates are so 'clear and unambiguous' (School District *v.* Stone, 106 U. S. 183, 187) as to estop the city from showing that the bonds were issued in violation or without authority of law, or that they, in conjunction with the certificate, foreclose all possible defenses. But when the law of the state provides for registry of municipal bonds and a certificate thereof, such certificate should be held as sufficient evidence to a purchaser of the existence of those facts upon which alone bonds can be registered. If the plaintiff in this case, not resting upon the mere terms of the certificate, had examined the records of the auditor's office, he would have found there the certificate, under oath, of the mayor of the city, of the election, its date, and facts necessary to warrant the issue of the bonds, such officer being the one named in the statute as the one to furnish to the auditor the evidence necessary to justify the registry. Can it be that a purchaser, with this evidence before him, is not protected by the statement upon the face of the bonds that they were issued in payment of a subscription? Is it his duty to examine all the proceedings, to see whether that which was a subscription in the first instance was called a subscription all the way through, and was named as a subscription in the bonds, had not been transformed by some action of the city council into a donation? It will be borne in mind that it is not a matter of law, but of fact, in respect to which an estoppel is urged against the city by virtue of the recitals and the fact of registry."

[1] Morton *v.* City of Nevada, (1890) 41 Fed. Rep. 582. See Jarrolt *v.* Moberly, 103 U. S. 586; Litchfield *v.* Ballou, 114 U. S. 190; s. c., 5 Sup. Ct. Rep. 820; Buchanan *v.* Litchfield, 102 U. S. 278.

§ 470. Miscellaneous rules as to city aid bonds. — Though properly a city, bonds issued by it under the name of a village will not be rendered invalid as against a *bona fide* purchaser where the legislature has recognized the corporation as a village, and it had acted as such.[1] Where an ordinance of a city regularly passed submitted to a vote of the inhabitants the question of issuing bonds to aid in the construction of a railroad, and the vote taken favoring the proposed aid, the road was constructed according to the terms of the ordinance, the Kentucky Court of Appeals held that the ordinance, without a subsequent contract of subscription, bound the city to issue the bonds.[2] Where an issue of bonds of a municipal corporation had been described in a notice of an election for their issue as "payable in gold or lawful money," as provided by the statute and with interest payable "annually," a subsequent ordinance of the corporate authorities making the bonds payable in gold coin "of the present standard of weight and fineness" with interest "semi-annually" has been held to have rendered the bonds invalid, when questioned before delivery to a purchaser.[3] A statute of Nebraska providing that the auditor shall detach coupons of municipal bonds presented to him for registration which mature before the first taxes levied to meet the coupons, has been held to apply to bonds issued by a city to aid a work of internal improvement.[4] The acceptance of bonds in payment of a subscription of a city to the stock of a corporation which is invalid because unauthorized, will not render the city a stockholder in the corporation.[5]

[1] Cornell University *v.* Maumee, 68 Fed. Rep. 418.

[2] Board of Trustees of Augusta *v.* Maysville & B. S. R. Co., (Ky.) 30 S. W. Rep. 1.

[3] Skinner *v.* City of Santa Rosa, (Cal.) 40 Pac. Rep. 742.

[4] Brinkworth *v.* Grable, (Neb.) 63 N. W. Rep. 952.

[5] City of Geneseo *v.* Geneseo Natural Gas, Coal, Oil, Salt & Mineral Co., (Kans.) 40 Pac. Rep. 655. As to estoppel of municipal corporation to assert lack of authority on the part of its officers in issuing aid bonds as against *bona fide* purchasers, see City of Columbus *v.* Dennison, 69 Fed. Rep. 58.

CHAPTER XXIV.

MUNICIPAL AID BONDS — TOWNS.

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§ 471. Aid by towns, generally.— It was held in an Illinois case that it was in the power of the legislature to bestow the power upon a town to subscribe for and take stock in a railroad directly, without requiring the subject to be submitted to a vote of the people.[1] Authority cannot be implied in municipal corporations to incur debts or borrow money in order to purchase stock or subscribe for shares of stock in railroad corporations; it must be conferred by express grant.[2] The power of municipal corporations to subscribe to the stock of railroad corporations and to issue bonds in payment of such subscription in aid of the enterprise must not only be clearly conferred, but the mode prescribed

[1] Keithsburg *v.* Frick, 34 Ill. 405.
[2] Pitzman *v.* Village of Freeburg, 92 Ill. 111.

by the statute conferring the power must be strictly pursued.[1] A clause in a railroad charter to this effect: "It shall be lawful for all persons of lawful age, or for the agent of any corporate body, to subscribe to the capital stock of said company," would confer no power upon municipal corporations to subscribe for such stock.[2] The rights of the holders of bonds of a town in aid of railroads depend upon whether there has in fact been a substantial compliance with the requirements of the law authorizing an election to be held upon the question of subscription and bonds for such purpose.[3] Bonds issued by a township in Kansas by the General Statutes are required to be "signed by the township trustee and attested by the town clerk." It was held in the federal court for that district that the township bonds sued on were not invalidated by the fact that the name of the township trustee was signed for him by a third person in his presence and at his request, the bonds being subsequently duly delivered and certified and the interest paid thereon by the township for ten years.[4] A township having voted aid by taking stock in a railroad company, under the Indiana statutes, the company would have no right to demand the money as a donation.[5] The law of Minnesota as to the issuance of bonds by towns in aid of railroads makes the limit of the indebtedness which may be created five per cent of the assessed valuation as determined by the last assessment. A case before the Supreme Court of that state involved the validity of certain town bonds of this description, it being claimed that the amount of the bonds issued was in excess of this limitation. The court declared that, in determining the amount of such indebtedness, the par value of the bonds was alone to be considered, and not the interest which might subsequently become due thereon

[1] Harding *v.* Rockford, Rock Island & St. Louis R. R. Co., 65 Ill. 90. That legislative authority is necessary for the legal issuance of municipal bonds in aid of railroads, see People ex rel. *v.* Jackson County, 92 Ill. 441; Gaddis *v.* Richland County, 92 Ill. 119; Town of Pana *v.* Lippincott, 2 Bradw. 466; Lippincott *v.* Town of Pana, 92 Ill. 24; Hewitt *v.* Board of Education, 94 Ill. 528; Schaeffer *v.* Bonham, 95 Ill. 368; Pitzman *v.* Freeburg, 92 Ill. 111.

[2] Campbell *v.* Paris & Decatur R. R. Co., (1874) 71 Ill. 311.

[3] Jacksonville, N. W. & S. E. R. R. Co. *v.* Town of Virden, 104 Ill. 339.

[4] Montgomery *v.* Township of St. Mary's, (1890) 43 Fed. Rep. 362. The court cited, as pertinent to their ruling: Ring *v.* County of Johnson, 6 Iowa, 272; Railroad Co. *v.* Marion County, 36 Mo. 303; Just *v.* Wise Township, 42 Mich. 575; s. c., 4 N. W. Rep. 298; Town of Weyauwega *v.* Ayling, 99 U. S. 112, 118.

[5] Board of Commissioners *v.* State 115 Ind. 64; s. c., 17 N. E. Rep. 855.

by the terms of the bonds.[1] In an action by an innocent purchaser against a township on railway aid bonds, which, on their face, refer to the act authorizing their issuance, and specifically recite the taking of each step required thereby, the township is estopped to allege invalidity of the bonds on any ground except that they were issued in violation of some constitutional or statutory requirement.[2] In a case in Illinois where a notice was given that an election would be had on a certain day to vote for and against subscribing an amount authorized by the statutes to the stock of a railroad corporation by the township, and subsequently another notice was given for an election on the same day for another subscription to the same corporation for another sum, the Supreme Court held that both elections were legal, and that one did not invalidate the other.[3] But, as the law authorizing a subscription by the township limited the amount of the subscription to the larger amount voted, the vote of the smaller amount, without any authority, was void and conferred upon the township authorities no power to issue bonds to the railroad corporation. They also held that the proceeding for this additional issue of bonds to the railroad corporation being void, the legislature had no power, under the Constitution, to pass a law rendering the election and subscription valid.[4] Where the power to subscribe to stock on the part of a town is to a particular division of a railroad, it would not be authorized to subscribe to the stock of the whole road.[5] The conditions of subscription and bonds or call for an election to authorize the same must be shown to have been complied with in *mandamus* proceedings to compel the town authorities to issue bonds voted by the town.[6] A suit in equity to restrain the payment of interest upon railroad aid bonds, and to require the bonds to be delivered up and canceled, may be brought by a town without awaiting an action at law upon the bonds, and setting up a defense to the action of the invalidity of

[1] Finlayson *v.* Vaughn, (1893) 54 Minn. 331; s. c., 56 N. W. Rep. 49; Durant *v.* Iowa County, Woolw. 71.

[2] Township of Washington *v.* Coler, (1892) 51 Fed. Rep. 362; citing Chaffee Co. *v.* Potter, 142 U. S. 355–364; s. c., 12 Sup. Ct. Rep. 216; Town of Coloma *v.* Eaves, 92 U. S. 491; Lake Co. *v.* Graham, 130 U. S. 674–681: s. c., 9 Sup. Ct. Rep. 654.

[3] Marshall *v.* Silliman, (1891) 61 Ill. 218.

[4] Ibid.; adhered to in Wiley *v.* Silliman, 62 Ill. 170.

[5] Town of Big Grove *v.* Wells, 65 Ill. 263; McWhorter *v.* People, 65 Ill. 290.

[6] People *v.* Chapman, 66 Ill. 137.

the bonds.[1] Where a township had, upon an election ordered by the public authorities under a mistaken idea of their power, voted for the subscription to the stock of a railroad company and the issuance of bonds in payment of the same, the Supreme Court of Illinois held that taxpayers were entitled to a perpetual injunction restraining the supervisors from issuing such bonds and the railroad company from receiving them.[2] Where the proposition submitted to the voters of a Kansas township containing a condition that if the county became a stockholder in the corporation, or issued bonds to it under any subscription, the subscription of the township was to be null and void, was adopted by the voters of the township at an election properly held under the statute of that state, the Supreme Court held that the subscription by the township was not avoided by the action of the railroad corporation to enforce a pretended subscription of the county and obtain the county bonds therefor, where, on final hearing of the action, the so-called subscription of the county was held invalid for want of power on the part of the county to make it, and no bonds were obtained thereunder.[3] Where the donation of money by a municipal corporation to aid in the construction of a railroad was authorized by law, and it was provided that a tax should be levied to raise the amount to be donated, it was held that the officers of the corporation could not adopt any other mode of paying the same, and that bonds issued by them for the purpose of paying such indebtedness were void.[4] A vote of the people of a town to subscribe to the stock of a railroad company, in the absence of a law authorizing such vote or subscription, will not be binding upon the town.[5] Where a town has authorized the issue of bonds, the signing of the bonds in blank, and leaving them with

[1] Town of Cherry Creek *v.* Becker, 2 N. Y. Supp. 514.

[2] Campbell *v.* Paris & Decatur R. R. Co., (1874) 71 Ill. 611.

[3] Atchison, Topeka & Santa Fe R. R. Co. *v.* Jefferson County, 21 Kans. 309. As to the burden of showing that bonds were authorized by a proper vote of the corporation at an election legally ordered and held, being upon those seeking to compel their issue or asserting their validity, see People *v.* Town of Bishop, 111 Ill. 124. That the issue of bonds or donations in aid of railroads will not be sustained under the power given them by legislative authority without a strict observance of the requirements as to the steps preliminary to an election, see Lippincott *v* Town of Pana, 92 Ill. 24.

[4] Town of Middleport *v.* Ætna Life Ins. Co., 82 Ill. 562; Lippincott *v.* Town of Pana, 92 Ill. 24.

[5] Barnes *v.* Town of Lacon, 84 Ill. 461.

others to hold until the conditions upon which they were voted are complied with by the railroad company, and afterward filling up the blanks, have been held were irregularities which could not prejudice the rights of innocent holders of the bonds.[1] Where the condition of the subscription of a town to the capital stock of a railroad company was that it should be paid upon the completion of the proposed railroad, and at the time the company should run over their track the first locomotive through that township, it was held that the leasing, temporarily, of the road of another company, and running a locomotive over that line through the township was not a compliance with the condition.[2] The law of the state, both constitutional and statutory, bearing upon the power of a municipality to issue bonds, is conclusively presumed to be known to the purchasers of municipal bonds, and the municipality cannot be estopped, by recitals in the bonds, to deny, even as against *bona fide* purchasers, the powers of commissioners appointed by the legislature to issue them.[3] In case a statute

[1] Niantic Savings Bank *v.* Town of Douglas, 5 Bradw. (Ill.) 579. That a consolidation of a road to which aid has been voted by a town with another will not defeat the donation, see Niantic Savings Bank *v.* Town of Douglas, 5 Bradw. (Ill.) 579.

[2] People *v.* Town of Clayton, 88 Ill. 45. That the consolidation of the road of a company which was to be aided by subscription to stock and issue of bonds, with another, would not release the subscription, see Edwards *v.* People, 88 Ill. 340; Town of Pana *v.* Lippincott, 2 Bradw. (Ill.) 466. As to the effect upon the subscription of a change of the route of railroad, see Town of Reading *v.* Wedder, 66 Ill. 80; Alley *v.* Adams County, 76 Ill. 101.

[3] Travelers' Insurance Co. *v.* Township of Oswego, (1893) 55 Fed. Rep. 361. That recitals in bonds as to the authority of officers to issue them where the authority was lacking are not binding upon the municipality issuing them, see Town of Pana *v.* Lippincott, 2 Bradw. (Ill.) 466. As to the power of towns to extend aid to railroad corporations, see Wood *v.* Commissioners of Oxford, 97 N. C. 227; s. c., 2 S. E. Rep. 653; Town of Enfield *v.* Jordan, 7 Sup. Ct. Rep. 358. For a statute that did not authorize aid by a town to a railroad company out of the town's revenue, see Macon & Birmingham R. R. Co. *v.* Gibson, 85 Ga. 1; s. c., 11 S. E. Rep. 442. Town aid bonds held not recoverable in Gilson *v.* Town of Dayton, 8 Sup. Ct. Rep. 66. The issue of such bonds held not authorized in Town of Concord *v.* Robinson, 7 Sup. Ct. Rep. 937. A contract for bonds, under a Kansas statute, limiting the amount to be issued, duly made and accepted by a railroad company, held binding on the township, and upon the performance of the conditions on its part the company held entitled to the bonds, in Chicago, K. & W. Ry. Co. *v.* Comrs., 38 Kans. 597; s. c., 16 Pac. Rep. 828. The bonds issued under what was known as the "Township Aid Act" of Missouri, though the act was held to be unconstitutional, it has been held were proper subjects of compromise, and under the statute authorizing the issue of compromise bonds subsequently passed, the tax levied to pay them was held to be valid. State *v.* Hannibal & St. Joseph R. R. Co., (Mo.) 11 S. W. Rep. 746. The Iowa statute requires that the notice of an election to raise a tax for a railroad shall show to what point the road shall be fully completed before the tax shall become due. Kleise *v.* Galusha, 78 Iowa, 310; s. c., 43 N. W. Rep. 217, following Allard *v.* Gaston, 70 Iowa, 731; s. c., 29 N. W. Rep. 752. Notice, simply stating that the tax shall become due on the completion of a certain number of consecutive miles of the road in a certain township by a specified time was held to be insufficient, and the tax voted at the election held to be void.

authorizing subscriptions in aid of a railroad is silent as to what the petition for and notice of the election shall contain as to the length of time the corporate bonds shall run before their maturity, and the election is called according to law, it will not be essential to the validity of the election that the time when the bonds shall mature should be fixed in the petition for or notice of the election and the vote of the people.[1] Where, in a town meeting attended by a majority of its legal voters, the question of calling an election for the purpose of voting on the proposition of donating the bonds of the town to a railroad company was before it, and the names of freeholders who were willing to sign a petition for such election were called for and publicly announced, and a committee appointed to prepare the petition, which they did, and signed the names of those freeholders to it, it was held that the freeholders having made no objection when their names were so announced, their silence must be construed as an express assent that their names should be signed to the petition by the committee.[2] Where the law under which a vote was taken on the question of a subscription by the municipal corporation to stock of a railroad corporation did not require the vote to be taken in reference to the stock of any particular company, but was in general terms to any railroad corporation leading to or from the town, a vote of a certain sum for railroad subscription, without designating any particular company, has been held to authorize a corporate subscription to the stock of a company whose road passed through the town.[3] It has been held by GRESHAM, United States Circuit

[1] People *v.* Town of Harp, 67 Ill. 62.

[2] Chicago, D. & V. R. R. Co. *v.* Coyer, 79 Ill. 373.

[3] Decker *v.* Hughes, 68 Ill. 33. When there is no power to compel the issue of bonds, see Springfield & I. S. E. Ry. Co. *v.* Cold Spring Township, 72 Ill. 603. An election for town aid bonds held invalid and not to have conferred authority for their issue. Harmon *v.* Auditor of Public Accounts, 22 Ill. App. 129; affirmed in 123 Ill. 122; s. c., 13 N. E. Rep. 161. When

Judge, that, under the Illinois decisions denying interest on the overdue interest coupons of railroad aid bonds, such interest was not recoverable in the federal courts.[1] There was a provision in a charter of a railroad company in Illinois authorizing the voting of municipal subscriptions for its stock, that the bonds should not be issued, nor any payment made on the subscription, until an amount of work shall be done on the railroad in the town, or on such part of the line of the road, as the authorities of the town shall designate, equal in value to the amount of the bonds to be issued. It was held that the charter required any deviation from the conditions therein prescribed to be submitted to the voters,

an election was held illegal and not to confer authority to make a subscription. People *v.* Town of Santa Anna, 67 Ill. 57; People *v.* Town of Laenna, 67 Ill. 65; Town of Pana *v.* Lippincott, 2 Bradw. (Ill.) 466; Lippincott *v.* Town of Pana, 92 Ill. 24. That the legislature may legalize and declare valid bonds issued by a town in aid of railroads without authority to do so, see Town of Keithsburg *v.* Frick, 34 Ill. 405.

[1] Bolles *v.* Town of Amboy, (1891) 45 Fed. Rep. 168. Issue of town aid bonds held unconstitutional in People *v.* Town of Bishop, 111 Ill. 124. Town aid bonds held unauthorized by reason of defective petition. Rich *v.* Town of Mentz, 134 U. S. 632; s. c., 10 Sup. Ct. Rep. 610. That bonds were issued upon the condition that the railroad company should build its shops in a town, held not to invalidate them in Casey *v.* People, 132 Ill. 546; s. c., 24 N. E. Rep. 570. Where a clerk of a town failed to record a provision of the vote of the town granting aid to a railroad, that the road should be completed by a certain date, an amendment of the record subsequently to the completion of the road, though the completion was after the date named in the condition, was not allowed to defeat the claim of the railroad company to the aid voted, in Sawyer *v.* Manchester & Keene R. R. Co., 62 N. H. 135. In Purdy *v.* Lansing, (1888) 128 U. S. 557, the bonds of this New York town, issued in aid of a certain railroad company, were held to have been issued without authority of law, and to be invalid on the ground that they had been issued without a previous designation by the company of all the counties through which the extension, authorized by the statute of New York relating to it, would pass. As to what was required by the statutes of New York, as to aid by towns preliminary to its being granted, see People *v.* Van Valkenburgh, 63 Barb. 105. Bonds of a town in aid of a railroad under New York statutes held void because of the omission of certain statements in the petition of taxpayers to the county judge, in Strang *v.* Cook, 47 Hun, 46. When a suit to cancel such bonds is not barred. Ibid. When a town was held entitled to a decree for the surrender and cancellation of its bonds in excess of the amount of aid authorized, obtained from the state treasurer on a false certificate of a town trustee that the conditions on which they were issued had been complied with, see Wilson *v.* Union Savings Assn., 42 Fed. Rep. 421. Payment of a tax voted in aid of a railroad by a township held not enforceable in Cantillon *v.* Dubuque & N. W. R. R. Co., (Iowa) 35 N. W. Rep. 620.

and at the election at which the subscription was voted, and that the town authorities could not, at pleasure, make any change as to the part of the road upon which the requisite amount of work should be expended.[1] The town in this case having voted a subscription to be paid in bonds to the amount of $50,000, the court held that the building of the road through the town at a cost of only $30,000 or even $41,000 was not a substantial compliance with the conditions, and that the court would not by *mandamus* compel the issue of the bonds voted.[2] Where the voters of an Illinois town had voted in favor of a proposition to make a donation in aid of a railroad, for which a tax was to be levied and the money paid to the railroad company, the Supreme Court of that state held that the proposition upon which they voted was entirely distinct from one to create a debt in respect to such donation, and a vote of that character would not be construed to authorize the issue of the bonds of the town for the amount so stated.[3] The words of a statute giving the right to prescribe the conditions upon which such subscriptions should be made or bonds issued, and declaring that such subscriptions or bonds should not be valid and binding until such conditions shall have been complied with, it has been held, by their natural force, extended to bonds under all circumstances, in whosesoever hands they might be.[4] Where a town has imposed conditions upon its subscription to stock, etc., of a railroad company, the supervisor of the town, on making the subscription, would have no power to disregard such conditions, nor would the railroad company have any right to demand that he should disregard them.[5] The conditions upon which a municipal subscription may have been valid in aid of a railroad, without express legislative authority, cannot be changed by a subsequent vote, either directly upon the proposition or indirectly upon a proposition to make a donation of a small sum with new conditions as to the donation and the issuing of bonds under the prior vote.[6]

§ 472. Bonds invalid unless conditions are complied with. — It was provided in the act passed April 16, 1869, in Illinois, that

[1] People *v.* Town of Waynesville, 88 Ill. 469.

[2] Ibid.

[3] Schaeffer *v.* Bonham, 95 Ill. 368.

[4] Town of Eagle *v.* Kohn, 84 Ill. 292; Parker *v.* Smith, 3 Bradw. (Ill.) 356.

[5] People *v.* Dutcher, 56 Ill. 144; People *v.* Holden, 91 Ill. 446.

[6] People *v.* Town of Waynesville, 88 Ill. 469.

"any county, township, city or town shall have the right, upon making any subscription or donation to any railroad company, to prescribe the conditions upon which such bonds, subscriptions or donations shall be made, and such bonds, subscriptions or donations shall not be valid and binding until such conditions precedent shall have been complied with." In an action upon interest warrants attached to bonds issued under this act in aid of a railroad, the defense of the town was a failure on the part of the railroad company to comply with some of the conditions upon which the bonds were issued. The trial court sustained a demurrer to the plea of the town. The Supreme Court of the state reversed the lower court, holding that the demurrer should have been sustained; that by virtue of the express declaration of the statute the bonds in question were not valid and binding until the conditions named had been complied with, even in the hands of innocent holders without notice.[1]

[1] Town of Eagle *v.* Kohn, (1876) 84 Ill. 292. *Arguendo*, it was said: "We do not think it is to be regarded that the conditions named were prerequisite to the making of the subscription and issuing of the bonds, and that they were to be complied with before the subscription could be made or the bonds issued; but only that the subscription and the bonds were to be subject to the conditions. There would then be no want of power to make the subscription and issue the bonds. As between the town and the railroad company, non-compliance with the conditions would be a good defense against the railroad company. But, irrespectively of the [provision of the act referred to above] we consider that it would be otherwise as against innocent holders for value, as are these appellees. It is the well-settled doctrine that bonds of this character are to be treated as commercial paper, and this court has held the coupons attached to them to be negotiable by delivery only, without indorsement. Johnson *v.* County of Stark, 24 Ill. 75. And, aside from the provision of the statute, we do not consider that *bona fide* holders for value would be required to take notice of such conditions, or the resolution upon the records of the railroad company, but they would enjoy the protection of *bona fide* holders of negotiable paper; and want of compliance with such conditions or resolution would not constitute any defense against them. * * * The words of the statute, by their natural force, apply to bonds under all circumstances, in whosesoever hands they may be. Courts are wont to allow to such peremptory language of a statute full force and effect, and where a statute expressly declares that negotiable securities, given under certain circumstances, shall be void, to hold them void, even in the hands of a *bona fide* indorsee. Thus, upon the English Statutes of Anne, declaring that promissory notes and bills of exchange, given for an usurious consideration, or for a gaming consideration, should be void, the English courts put the construction that the securities were void in the hands of a *bona fide* indorsee without notice. And so this court has held, under our statute in respect to a bill of exchange for a gaming consideration. Chapin et al. *v.* Dake, 37 Ill. 296. And the doctrine is laid down generally that in those cases in which the legislature has declared that the illegality of the contract shall make the security, whether bill or note, void, the defendant may insist on such illegality, though the plaintiff took the bill or note *bona fide*, and gave a valuable consideration for it. Chit. on Bills, 115, and cases cited in note. But, unless it has been *so expressly* declared by the legislature, illegality of consideration will be no defense in an action at the suit of a *bona fide* holder, without notice of the illegality, unless he obtained the bill or note after it became due. Chit. on Bills, 116. True, there is nothing of illegality in the bonds in question, nor does the statute declare them void. But illegality is not the circumstance which avoids negotiable securities in the hands of a *bona fide* holder, as it is seen that illegality of consideration, in the absence of express declaration by the legislature that the securities shall be void, will be no defense against a *bona fide* holder without notice of the illegality. It is by force of the peremptory words of the statute declaring them void, that they are to be held to be void in the hands of an innocent indorsee without notice. The words of the statute in question, though not that the bonds shall be void, are that they shall not be valid and binding until the conditions are complied with. They are equally imperative to the degree named as language declaring securities void. The bonds are not declared to be, to their whole extent, not valid and binding, but *are* declared to be to a certain extent, not valid and binding; that is, until the conditions are complied with."

§ 473. How irregularity of election affects the validity of bonds.— It was insisted in a case before the United States Supreme Court that the township bonds upon which the suit was brought were invalid because of the irregularity of the election to ascertain the will of the legal voters in the matter of a subscription to the stock of the railroad company, in two respects: (1) Because a majority of the legal voters of the township did not vote at the meeting notified and held for that purpose; (2) because the meeting was notified and held before the act was passed providing for such an election. The court held that the true intent of the legislature in adopting the phrase "a majority of the legal voters of the township," intended to require only a majority of the legal voters of the township voting at the election notified and held to ascertain whether the proposition to subscribe for the stock of the company should be adopted or rejected.[1] The court also held that the second objection was not a good one for the reason that the statute by its terms cured

[1] See on this point, People *v.* Warfield, 20 Ill. 163; People *v.* Garner, 47 Ill. 246; People *v.* Wiant, 48 Ill. 263; Railroad *v.* Davidson County, 1 Sneed, 692; Bridgeport *v.* Railroad, 15 Conn. 475; Talbot *v.* Dent, 9 B. Mon. 526; State *v.* The Mayor, 37 Mo. 272.

all defects growing out of any irregularities as to the election, and, if not, that the act in one of its sections made it the duty of the supervisor who executed the bonds to determine the question whether an election was held, and whether a majority of the votes cast were in favor of the subscription, and inasmuch as he passed upon that question and subscribed for the stock and subsequently executed and delivered the bonds, it was too late to question the validity where it appeared, as in this case, that the bonds were in the hands of an innocent holder.[1] The United States Supreme Court held in a case that an irregularity in conducting the election would not defeat a recovery on the bonds or on the coupons thereto attached, nor overcome the presumption that the plaintiff, in the usual course of business, became at their date the holder of them for value; that the burden of proving that he was an innocent holder of the bonds for value was not cast upon him by such an irregularity in conducting the election.[2]

[1] St. Joseph Township *v.* Rogers, (1872) 16 Wall. 644. See Knox County *v.* Aspinwall, 21 How. 544; Supervisors *v.* Schenck, 5 Wall. 783. The same principles were applied in Royal British Bank *v.* Turquand, 5 Ell. & Bl. 259; s. c., 6 Ell. & Bl. 331.

[2] Pana *v.* Bowler, (1882) 107 U. S. 529. It was said: "It is a general rule that when the holder of a negotiable instrument, regular on its face and payable to bearer, produces it in a suit to recover its contents, and the same has been received in evidence, there is a *prima facie* presumption that he became the holder of it, for value at its date, in the usual course of business. Murray *v.* Lardner, 2 Wall. 110; Bank of Pittsburg *v.* Neal, 22 How. 96; Collins *v.* Gilbert, 94 U. S. 753; Brown *v.* Spofford, 95 U. S. 474. And municipal bonds, payable to bearer, are subject to the same rules as other negotiable paper. Cromwell *v.* Sac County, 96 U. S. 51. But the plaintiff in error insists that this case falls within an exception to that rule, and cites to sustain his position Smith *v.* Sac County, 11 Wall. 139, and Stewart *v.* Lansing, 104 U. S. 505. The exception relied on by the plaintiff in error is well settled, and is this: If, in a suit brought by the indorsee or transferee of a negotiable instrument, the maker or acceptor, or any party who is primarily bound by the original consideration, proves that there was fraud or illegality in the inception of the instrument, the burden of proof is thrown on the plaintiff to show that he is a holder for value. Smith *v.* Sac County, 11 Wall. 139, and Stewart *v.* Lansing, 104 U. S. 505; Commissioners *v.* Clark, 94 U. S. 278 [and many others]. In most of the cases above cited the defense relied on was fraud in the inception of the instrument. Thus, in Smith *v.* Sac County, 11 Wall. 139, the report shows that the bonds were issued to a contractor to pay for the building of a court house; that the county judge who executed and delivered them was bribed to do so, and that the court house never was built. In Stewart *v.* Lansing, 104 U. S. 505, the county judge rendered a judgment appointing commissioners to execute bonds of the town of Lansing. This judgment was carried by *certiorari* to the Supreme Court and there reversed. The county judge, the commissioners and the railroad company to which the bonds were ordered to be issued, all had notice of the *certiorari* and the subsequent proceedings under it. Before the judgment of reversal, however, the commissioners, notwithstanding the pendency of the writ, issued the bonds in suit in the case, taking from the company an obligation for their personal indemnity. The court held that as between the company and the town the judgment of reversal was equivalent to a refusal by the county judge to make the original order and invalidated the bonds. There is no pretense of any fraud in the inception of the bonds in this case. It is not denied that they were issued in good faith and for a valuable consideration. The question then arises: Is the irregularity in the conduct of the election such an illegality as throws on the plaintiff the burden to show that he paid full value for the coupons? We are clearly of opinion that it is not. It will appear from an examination of the cases above cited, in which the defense was illegality in the inception of the instrument, that the illegality which shifts the burden of proof on the holder to prove that he paid value must be something which relates to the consideration of the paper sued on. It must appear that the consideration arose out of a transaction contrary to law, or against public policy." The court then commented upon certain of the cases and summed up, on this point, in the following words: "The authorities illustrate the rule and show that it does not apply to this case. There was no illegality whatever in the consideration of the bonds in question in this suit. The mere irregularity in the conduct of the election was not such an illegality as is contemplated by the rule, and does not deprive the holder of the coupons of the presumption that he acquired them for value."

§ 474. Effect of recitals on face of bonds.—In an action upon coupons of township bonds, issued by a township in Illinois in payment of a subscription to the capital stock of a railroad company under certain acts of the legislature incorporating this railroad company, the Supreme Court of the United States reaffirmed its ruling in Harter *v.* Kernochan, 103 U. S. 562, that the duly signed and countersigned township bonds, payable to the company or bearer, which recited that they were duly issued in compliance with the vote of the legal voters of the township, cast at an election held by virtue of those acts of the legislature, were valid in the hands of a *bona fide* holder.[1]

[1] Pana *v.* Bowler, (1882) 107 U. S. 529. Mr. Justice Woods, speaking for the court, said: "This court has again and again decided that if a municipal body has lawful power to issue bonds or other negotiable securities, dependent only upon the adoption of certain preliminary proceedings, such as a popular election of the constituent body, the holder in good faith has the right to assume that such preliminary proceedings have taken place if the fact be certified on the face of the bonds by the authorities whose pri-

§ 475. The power of commissioners of towns for issuing aid bonds under New York statutes.— The Court of Appeals of New York has held that the acts of commissioners appointed to execute and issue the bonds in the proceedings under the statutes of that state authorizing the issuing of bonds by towns in aid of railroads, as to all matters within the scope of the authority

mary duty it is to ascertain it. Lynde *v.* The County, 16 Wall. 6; Town of Coloma *v.* Eaves, 92 U. S. 484; Commissioners *v.* January, 94 U. S. 202; Commissioners *v.* Bolles, 94 U. S. 104; County of Warren *v.* Marcy, 97 U. S. 96. The authority to issue the bonds in question in this case, resting upon the fact that an election was held in pursuance of law before a certain date, namely, the date when the Constitution of 1870 was adopted, and the bonds reciting on their face the fact that the election was so held before the date mentioned, the circumstance that the election was irregularly conducted can be of no avail as a defense to the bonds in a suit brought by a *bona fide* holder." The court's attention was called to several Illinois decisions (Lippincott *v.* Town of Pana, 92 Ill. 24), in which it was held that the election relied on in this case as the authority for the issue of the bonds was absolutely void, and the issue of the bonds was, therefore, without authority. People *v.* Town of Santa Anna, 67 Ill. 57, and People *v.* Town of Laenna, 67 Ill. 65, where similar elections under a like statute were held void. The court said of these cases: "The last two cases were decided before the bonds in this case were issued. They were, however, suits brought to restrain the issue of bonds by the township officers, on account of the irregularities in the election. The rights of *bona fide* holders could not, therefore, arise and were not passed on in those cases. But in the case first mentioned the bonds had been issued and were presumptively in the hands of *bona fide* holders. Nevertheless, the Supreme Court of Illinois held the bonds to be void in whosesoever hands they might be. It is insisted that this court is bound to follow this decision of the Supreme Court of Illinois and hold the bonds in question void. We do not so understand our duty. Where the construction of a State Constitution or law has become settled by the decision of the state courts, the courts of the United States will, as a general rule, accept it as evidence of what the local law is. Thus, we may be required to yield against our own judgment to the proposition that, under the charter of the railway company, the election in this case, which was held under the supervision of a moderator chosen by the electors present, was irregular and, therefore, void. But we are not bound to accept the inference drawn by the Supreme Court of Illinois, that in consequence of such irregularity in the election the bonds issued in pursuance of it by the officers of the township, which recite on their face that the election was held in accordance with the statute, are void in the hands of *bona fide* holders. This latter proposition is one which falls among the general principles and doctrines of commercial jurisprudence, upon which it is our duty to form an independent judgment, and in respect of which we are under no obligation to follow implicitly the conclusions of any other court, however learned or able it may be. Swift *v.* Tyson, 16 Pet. 1; Russell *v.* Southard, 12 How. 139; Watson *v.* Tarpley, 18 How. 517; Butz *v.* City of Muscatine, 8 Wall. 575; Boyce

conferred upon them by the statutes, are the acts of the town.[1] Further, it was held that irregularities in the manner in which such commissioners may have performed their duties could not affect the validity of the bonds in the hands of an innocent holder for value.[2] The court further held that the employment by the commissioners of the president of the railroad company, to the stock of which the town had subscribed and was to issue its bonds in payment of the subscription, who was a banker, as a broker to sell the bonds and invest the proceeds according to their instructions, was allowable under the law.[3] The lawfully appointed broker for the commissioners who issued the town bonds in this case sold bonds to an amount less than ten per cent of the amount authorized to a purchaser, who brought his action against the town. The original act authorizing these railroad aid bonds by towns provided for bonds running thirty years. This portion of the act was afterwards amended, as follows: "The said commissioners may issue the said bonds, payable at any time they may elect, less than thirty years, * * * but they shall not so issue the bonds that more than ten per cent of the principal of the bonds shall become due and payable in one year." The bonds sued on were twenty-year bonds. The town objected to a recovery upon these bonds, claiming that there was no authority when they were issued to issue bonds for twenty years, they being of date prior to the passage of the amendatory act, and that if the

v. Tabb, 18 Wall. 546; Oates *v.* National Bank, 100 U. S. 239; Railroad Company *v.* National Bank, 102 U. S. 14. See, also, Burgess *v.* Seligman, 107 U. S. 20, where the question how far the courts of the United States are bound by the decisions of the state courts is carefully re-examined and the rule on the subject stated with precision." It was further said: "We cannot follow the decision of the Supreme Court of Illinois in Lippincott *v.* Town of Pana, 92 Ill. 24, without overruling a uniform current of the decisions of this court beginning with Commissioners of Knox County *v.* Aspinwall, 21 How. 539, and continuing down to the present time. The rights of the *bona fide* holders of negotiable municipal bonds, as we have stated them in this opinion, are too firmly settled by the decisions of this court to be shaken."

[1] Brownell *v.* Town of Greenwich, (1889) 114 N. Y. 518; citing Gould *v.* Town of Oneonta, 71 N. Y. 298.

[2] Brownell *v.* Town of Greenwich, (1889) 114 N. Y. 518; citing Town of Solon *v.* Williamsburgh Savings Bank, 114 N. Y. 122.

[3] Brownell *v.* Town of Greenwich, (1889) 114 N. Y. 518. The court said: "It was not necessary that merely executive acts, not involving the exercise of discretion, should be done by the commissioners personally, but such acts might be done by another under their direction. Mayor *v.* Sands, 105 N. Y. 210, 217. When a statute com-

amendatory act was operative then there was a violation of the limitation of that act with reference to the amount of bonds which can be made payable in one year. The Court of Appeals of New York held that the bonds were valid obligations of the town, and enforceable by the owner or *bona fide* purchaser for value.[1] A certain amount of the bonds of this town which had

mands an act to be done it authorizes all that is necessary for its performance."

[1] Brownell *v.* Town of Greenwich, (1889) 114 N. Y. 518. The court said: "[The bonds] bear the date [prior to the passage of the amendatory act], and are presumed to have been executed at that time; but executing is not issuing, for they might be fully executed but never issued. It is clear that the purchaser of a bond from the obligor named therein simply lends the latter money. Coddington *v.* Gilbert, 17 N. Y. 489; Ahern *v.* Goodspeed, 72 N. Y. 108. The essence of the original transaction between the parties, therefore, was a loan of money secured by the bonds of the borrower. The bonds had no legal inception, and could not become valid obligations, aside from any other question, until actually delivered for a valuable consideration. Under the circumstances, we think that the delivery of the bonds to the plaintiff determines the date when his bonds were issued. In this vital respect the case differs from Potter *v.* Town of Greenwich, 92 N. Y. 662; 26 Hun, 326, where the bonds were issued prior to the passage of the [amendatory] act. * * * The plaintiff in that case bought his bonds [prior to that date]." The bonds here were purchased July 1, 1871, after the passage of the amendatory act. The court said of them: "[They] were issued on [the date of purchase], when they were first delivered as evidence of an existing debt. The plaintiff had the right to assume that they were issued under the statute as it stood at the date of delivery, for he was dealing with actual commissioners, clothed with all the authority that the state conferred. The mere inspection of his bonds would show that *they* were made payable as the statute then required. It does not appear that he had seen any of the bonds except those which he purchased, or that he knew that all of the bonds were payable at the same time, or even that any other bonds had been issued at the date of his purchase. He was not bound to examine the entire series to see that no more became due in a single year than the statute permitted. He was bound to examine his own bonds, and was, doubtless, charged with knowledge of the bonding act and the bonding roll, as the one was a public statute and the other a public record, and both were accessible to all. How could he examine the remaining bonds? If they were not then issued, but still in the hands of the commissioners, an examination would be useless, for a purchaser of bonds issued according to law, cannot be affected by the subsequent acts of the commissioners in issuing other bonds in a manner not in accordance with law. If they were issued, how could he find them, scattered in the hands of unknown owners? It would be unreasonable to charge him with knowledge of the contents of the rest of the bonds, or to declare his bonds void because the others, of which he knew nothing and had no means of knowing, were, in fact, made payable at a time not authorized by the statute. A purchaser, under the circumstances disclosed, might assume

been issued in aid of a railroad company in a proceeding under the New York statutes providing for and authorizing such bonds, had been returned to the commissioners appointed to execute and issue them and other bonds, to the same amount substituted by the commissioners, larger in amount, severally, and payable at a different place, which, it was assumed, would make them more salable. In the town's action against the bank which held some of these bonds, to have them surrendered and canceled, one of the grounds upon which they were claimed to be invalid was that there was no authority in the commissioners to substitute these bonds for the others. The Court of Appeals held that the commissioners had the power to substitute the bonds last issued for those surrendered to them by the holders, and that the substituted bonds were not invalid.[1]

that the defendant, through its lawfully appointed commissioners, would not do an act utterly void, and thereby commit a fraud upon one of its citizens by taking his money without any consideration."

[1] Town of Solon *v.* Williamsburgh Savings Bank, (1889) 114 N. Y. 122. The court said: "The bonds issued pursuant to the statute were the obligations of the town, and in the performance of their defined duty in that respect, the commissioners represented the [town], and, in some sense, their relation was that of agency. When the proceeding for the purpose has been (as is treated to have been in this case) legally conducted to the appointment of such officers, irregularities in the manner in which they perform their duties do not affect the validity of the bonds issued in the hands of an innocent holder for value. Town of Lyons *v.* Chamberlain, 89 N. Y. 586. The bonds are in form negotiable, and while they cannot be treated as commercial paper, to the extent of the rule applicable to it in that respect, they have the character of negotiability sufficient to furnish, under some circumstances, protection to a *bona fide* holder, which he otherwise would not have for the support of his claim upon them. Bank of Rome *v.* Village of Rome, 19 N. Y. 20; Brainerd *v.* N. Y. C. R. R. Co., 25 N. Y. 499. The liability of the municipal corporation is dependent upon the statute, and its observance in the proceedings had with a view to the creation of such obligations. And when there is a failure to comply with the statute in the steps taken to vest the power in those officers to create the bonds, there can in this state be taken no rights by a person as a *bona fide* holder. Cagwin *v.* Town of Hancock, 84 N. Y. 532; Craig *v.* Town of Andes, 93 N. Y. 405. So far as we have observed, the doctrine of the cases does not necessarily go any further in that respect. The examination of the proceedings before the county judge disclosed their regularity and showed that the persons whose names were subscribed to the bonds were only appointed, and by the statute vested with the power to issue bonds like those in question. While the commissioners were not appointed by the town or clothed with power by it, the power to exercise their statutorily defined duties was given pursuant to the requisite consent of the taxpayers. The question, therefore, arises whether, by this issue of the substituted bonds, the [town]

The Constitution of the state of New York which went into effect January 1, 1875, declared: "No county, city, town or village shall hereafter give any money or property, or loan its money or credit, to or in aid of any individual, association or corporation, or become directly or indirectly the owner of stock in, or bonds

was charged with liability. The issue of bonds outstanding in excess of the amount authorized would have been void. That was not the case here, and the [town] was practically unaffected by those put in place of the ones surrendered. The [town], through the commissioners, paid the interest coupons upon them for several years, and the defendant was the holder of them for six years before this action was commenced. These facts might be entitled to some consideration upon the question of *laches*. Alvord *v.* Syracuse Sav. Bank, 98 N. Y. 599, 610. But we do not place our conclusion upon that ground. The defendant was a *bona fide* holder of these bonds, and as such relied upon the authority with which the commissioners were lawfully clothed. To charge the [town] upon them would not increase its apparent liability beyond that which it undertook by the proceeding had pursuant to the statute to assume. So there is no equity in its behalf as against the defendant, to support this action for their cancellation arising out of the substitution. The defendant was, not only by the apparent situation at the time of the purchase, but by the continued recognition of the obligation of the bonds for several years thereafter, induced to understand that they were in all respects lawfully created. And they were, in fact, issued and delivered by the persons clothed with power to issue the bonds of the town. The extrinsic fact now relied upon to deny to them the power to issue these particular bonds at the time and in the manner it was done, was peculiarly within the knowledge of those persons so selected to represent the town in that respect. This, as between principal and agent, is sufficient to charge the former with the consequences of the act of the latter in the scope of his apparent authority, as against an innocent party acting in reliance upon such situation, although authority to do the particular act does not, in fact, exist. N. Y. & N. H. R. R. Co. *v.* Schuyler, 34 N. Y. 30; Bank of Batavia *v.* N. Y., L. E. & W. R. R. Co., 106 N. Y. 195. This proposition may not, to the full extend to which it is applied to the relation of an agent clothed by his principal with authority, be applicable to the commissioners in their relation to the town for which they are appointed to perform the duties devolved upon them, but in the reason of it is illustrated a principle which may be applied to the circumstances of the present case in reference to the execution of the bonds in question. In the cited case of Horton *v.* Town of Thompson, 71 N. Y. 513, the bonds appeared to have been, in terms, issued in violation of the statute pursuant to which the consent of the taxpayers was given, upon which the proceeding taken was had. And the remarks of the learned judge who delivered the opinion may be treated as applicable only to the case as there presented. They represent the town in the exercise of the powers with which they are vested. Cagwin *v.* Town of Hancock, 84 N. Y. 542; Alvord *v.* Syracuse Savings Bank, 98 N. Y. 599. The practical effect of this subscription of the bonds was not an excessive issue, but the continuance

of, any association or corporation, nor shall any such county, city, town or village be allowed to incur any indebtedness except for county, city, town or village purposes." A town of New York had, previously to the adoption of this amended Constitution, in proceedings instituted under the acts of the state relating to such matters, determined to issue its bonds in aid of a railroad company. The act of 1870 authorized the commissioners of the town appointed in such proceedings and the railroad company to enter into an agreement for limiting and defining the times when and proportions in which the bonds should be delivered, and the places where and the purposes for which they should be applied. It also provided that "the petition" [of the taxpayers] may be absolute or conditional, and, if the same be conditional, the acceptance of a subscription founded on such petition shall bind the railroad company accepting the same to the observance of the condition or conditions specified in such petition. The petition in this case was for authority to issue bonds to a certain amount to a certain railroad company, conditioned that its road be constructed from a certain point to a certain other point and to pass through a certain village in this town. The commissioners of the town just afterwards, the issue of the bonds having been authorized, entered into an agreement with the railroad company to deliver the bonds when those conditions, referring to the petition, on the part of the railroad company were performed. In a statutory proceeding, upon an agreed statement of facts, before the Supreme Court of the state of New York, after the adoption of the amended Constitution, in which the railroad company prayed for an order directing the issue of the bonds and the subscription of the stock, and the commissioners prayed for a decree against such issue and subscription, the decree was made as prayed by the commissioners. This was affirmed by the Court of Appeals of that state. The Court of Appeals held that there was no contract in existence, as alleged by the railroad company, when the amended Constitution went into effect, and, therefore, that the

of those issued, modified in form, not in substance, and these were the only ones, with others outstanding, which covered the amount of the stock of the railroad company, to which the commissioners had subscribed for the town, and for which they had undertaken to issue its bonds for a like amount." The case of The Town of Solon *v.* Williamsburgh Savings Bank, (1889) 114 N. Y. 122, was thoroughly discussed and its conclusions adhered to in Williamsburgh Savings Bank *v.* Town of Solon, (1893) 136 N. Y. 465.

prohibition contained in the Constitution before quoted was conclusive against the right and power of the town to issue the bonds and subscribe for the stock which formed the subject of this litigation. A writ of error was taken to the United States Supreme Court upon the constitutional question involved, and they considered whether any such contract, valid and binding on this town, did exist at the time of the adoption of the amended Constitution. In the opinion rendered in the case by the United States Supreme Court Mr. Justice BRADLEY, speaking for the court, made this statement of the facts, that "the railroad was not constructed through [the village named in the petition and agreement before referred to] until the 20th of October, 1875. On the 1st of January, 1875, when the amended Constitution went into effect, nothing had been done except to survey the route and file a map thereof." The court affirmed the decision of the New York Court of Appeals, holding the agreement made by the commissioners with the railroad company *ultra vires* and not binding upon the town.[1]

[1] Railroad Company *v.* Falconer, (1880) 103 U. S. 821. It was said, as to the power of these commissioners in the matter: "Their powers were confined to subscribing for the stock and making and issuing the bonds in payment thereof when and as the petition of the taxpayers directed; that is, after the road was completed through [the village in the town]. By the act of 1870 they might also stipulate as to the installments in which the bonds should be delivered, and the purposes for which they might be applied. But the power to do this being but an incident of the principal power to make and issue the bonds, and being only intended to enable the commissioners to prescribe the times and manner of their issue and the uses to which they should be applied, would not properly arise and could not be effectively exercised until the principal power itself arose and became exercisable. Whilst, however, the commissioners had the power, or, rather, would have the power, at the prescribed time, to subscribe for the stock and to execute and issue the bonds, neither the statutes nor the taxpayers' petition gave them any power to make a contract to subscribe for stock, nor a contract to deliver bonds to the railroad company. They were not charged with any such duty; they were not invested with any such power. The case of the railroad company, therefore, must stand upon the effect of the taxpayers' petition and the proceedings had thereon before the county judge. If, under the operation of existing statutes, these proceedings amounted to a contract between the town and the railroad company, no subsequent legislation or constitutional amendment could lawfully impair its obligation. But it is difficult to see how said petition and proceedings, including the appointment of commissioners, can be considered as amounting to such a contract. All that was done by the town, through the action of its taxpayers and the county judge, was to appoint agents for making a subscription and issuing bonds on the happening of a certain event. When that event should happen it would be the duty of these agents, under [a] section of the act of 1869, to execute their commission. The words of the section are: 'Such commissioners are further empowered and *directed* to subscribe,' etc. But to whom did they owe this duty? Evidently to the town which appointed them; not to the railroad company. The latter came under no obligation and acquired no rights until the commissioners should subscribe to its stock. Had no conditions been imposed by the petition, the duty of the commissioners to subscribe stock and issue bonds would have arisen immediately after their appointment; but it would have been an obligation owed to their principals alone. The conditions which were in fact imposed required, it is true, something to be done by the railroad company before the commissioners could act; but no stipulation was demanded of the company, or given by it, that this something should be done. The two parties were not brought together. There was no mutuality between them. Each was free to act as it listed. This was the condition of things on the 1st of January, 1875, when the new Constitution went into operation, prohibiting all municipal aid to corporations or individuals, by subscription of stock or otherwise. It seems to us, therefore, that the New York Court of Appeals was right in deciding that no contract existed at that time. After the amendment took effect, no county, city, town or village could subscribe for railroad stock; and, of course, no agent or attorney of any such corporation could do so. What had not been done before, in this regard, could not be done afterwards, unless some valid contract required it to be done. But, as we have shown, no such contract existed in this case, The action on the part of the town was voluntary up to the time of the constitutional amendment. The railroad company may have expected a subscription when their road should be completed; but they had no subscription, and had no valid agreement that any should be made. Everything was inchoate and undetermined up to the first day of January, 1875, and then all power to subscribe for stock was taken away from the town." County of Moultrie *v.* Savings Bank, 92 U. S. 631, was relied upon to sustain the position that a contract did exist in this case. It was distinguished by the United States Supreme Court as follows: "But an examination of that case will show that it was very far from being parallel to the present. Here the statute of Illinois authorized the board of supervisors of the county of Moultrie to subscribe to the stock of a particular railroad company by name, to an amount not exceeding eighty thousand dollars, and to issue bonds therefor when the road

§ 476. The sealing of such bonds.— A town of New York issued bonds in aid of a railroad corporation. The town had no common seal. The attestation clause of each bond was: "In witness whereof the within named commissioners * * * have caused this bond to be made and executed and have set their hands and seals hereto the first day of ——— in the year ——;" and they subscribed their names as commissioners, and opposite each name was the scroll [L. S.]. In an action by the town against a bank, the holder of these bonds, praying that they be

surrendered and canceled, it being claimed that they were invalid on account of the manner in which they had been executed and sealed by these commissioners appointed in the proceedings before a county judge under the New York statutes to execute and issue them to the railroad company, the Court of Appeals, while conceding that the doctrine established in that state did not permit the conclusion that the seal upon the bonds in question was the seal of the commissioners, held that it did not follow that the bonds were for that reason invalid, and inasmuch as they were issued and delivered by the commissioners in the performance of their duty, and upon a consideration, the mistake or failure to affix their seals did not defeat the enforceable validity of the bonds.[1] At the time the bank became the holder and owner of

should be opened for traffic between certain points. Before this event took place, the board ordered that a subscription to the stock of the company in the sum of eighty thousand dollars be made, and that, in payment therefor, bonds should be issued to the company when the road should be open for traffic. This resolution was acted upon by the railroad company as a subscription, and was entered on its minutes, and the promised bonds were disposed of by contract. This court held that the board of supervisors itself had complete authority to make a present subscription, and that the resolution amounted to a subscription, or, at least, to an agreement to subscribe, which, being accepted and acted upon by the railroad company as such, created a contract between the county and the company. In the case before us, no act equivalent to the action of the board of supervisors of Moultrie county was ever done by any person or body of persons, having, at the time of such act, a present power to subscribe for stock or to issue bonds of the town [involved in this case]. The taxpayers had no authority to make a subscription of stock or to issue bonds, or to make any contract to do so; they could only express their desire that it should be done, and that commissioners should be appointed to do it; and when they did express such desire it was continued, as before stated. The commissioners, as we have seen, had no power to act, for no power was given them to act until the railroad was located and completed through [a named village of the county]. It follows that nothing which was done in the present case can be fairly regarded as equivalent to the action of the parties in the case of Moultrie county. The circumstances of the two cases were essentially different."

[1] Town of Solon *v.* Williamsburgh Savings Bank, (1889) 114 N. Y. 122; citing People ex rel. *v.* Mead, 24 N. Y. 114; Kelly *v.* McCormick, 28 N. Y. 318; Board of Education *v.* Fonda, 77 N. Y. 350; San Antonio *v.* Mehaffy, 96 U. S. 312; United States *v.* Linn, 15 Pet. 290. The court additionally said: "At all events, as the commissioners intended to properly and effectually execute the bond, and the omission of the seals was caused by their misunderstanding, mistake or inadvertence, the court of equity may afford the relief requisite to the party justly entitled to the benefit of the instruments and to render them enforceable." Citing Wiser *v.* Blachly, 1 *v.* Stebbins, 109 U. S. 341; Cockerell Johns. Ch. 607; Bernards Township *v.* Cholmeley, 1 Russ. & Myl. 418.

these bonds seals had been affixed and were upon them over the places where the scroll opposite the names of the commissioners using them was placed so that the bonds then appeared to have been properly sealed. The defendant purchased them in good faith, and then supposed that the seals were those of the commissioners. The evidence tended to prove that the seals were not affixed by any officer of the railroad company who received them from the commissioners, and that they were not upon them when transferred by the company. It did not appear who were all the intermediate holders of the bonds between the transfer of them by the railroad officers and the purchase by defendant. The trial court found that these seals were affixed by a stranger. Whether or not this worked an alteration of the bonds and its effect upon the rights of the holders was discussed by the Court of Appeals as follows: "If placed there by some one having no interest in the bonds and without any authority, consent or complicity of any person having any interest, the seals would not be treated as effecting any alteration of the bonds. [Citing cases.] If, therefore, this was done by a stranger in the sense of the term applicable in such case, the alteration produced by it would not be effectual to impair the right before existing to enforce the bonds. But, inasmuch as they passed through the hands of other owners before they reached the defendants, it is contended that the finding that it was done by a stranger is not supported, and that the presumption arises that the seals were affixed by some party having an interest in having them put on, and, therefore, explanation is necessary to relieve them from the effect of the alteration. As a general rule, when a material alteration appears to have been made in a written instrument after its execution, evidence is necessary to explain it, and the burden of proof rests upon the party seeking to enforce it to do so to support a recovery upon it. [Citing cases.] The plaintiff's counsel seeks to apply that rule in respect to the burden of proof to this case, and insists that the defendant must bear it. While the burden is with a party seeking to enforce a contract, to relieve it from the effect of any material alteration made in it after its inception, that rule is not necessarily applicable to a defendant in an action brought to have a security held by him canceled upon that ground, when it

appears that such defendant is in no sense chargeable with *mala fides* in that respect. Our attention is called to no authority going to that extent. And the proposition does not seem to commend itself to a court of equity, which is supposed, within recognized bounds, to exercise discretionary powers in such cases."[1]

§ 477. Proceedings under New York statutes preliminary to issue of bonds.— A town of New York which had through commissioners appointed for that purpose issued bonds to a certain amount, under the statute authorizing it, in aid of a railroad company, some of which were held by a bank, brought its action in equity against the bank, charging such irregularities, etc., and non-compliance with the statute, as would render the bonds invalid as the town contended, and praying to have the bonds surrendered up and canceled. A judgment was rendered in favor of the defendant, affirmed in General Term and the Court of Appeals when it was considered there affirmed the judgment, holding the bonds to be valid and binding upon the town. The statute under which these bonds were issued provided that "whenever a majority of the taxpayers of any municipal corporation in this state, whose names appear upon the last preceding tax list or assessment roll of said corporation, shall make application to the county judge of the county in which such corporation is situated, by petition, verified by one of the petitioners, setting forth that they are such a majority of taxpayers and represent such a majority of taxable property," etc., the further proceedings may be taken as therein provided for the requisite adjudication and the appointment of commissioners to issue the bonds of the corporation and invest them in the stock or bonds of the railroad company, in view of which the proceeding was taken.[2] The petition addressed to the county judge under this statute in this case contained this statement: "The undersigned, representing a majority of the taxpayers of the town of Solon, in said county of Cortland, whose names appear upon the last preceding tax list or assessment roll of said town," etc. It was signed by persons purporting to be citizens of that town, and upon the petition was the verification by the affidavit of one of

[1] Town of Solon *v.* Williamsburgh Savings Bank, (1889) 114 N. Y. 122, 134, 135; citing on that point McHenry *v.* Hazard, 45 N. Y. 580; Town of Springport *v.* Teutonia Savings Bank, 75 N. Y. 397–408.

[2] N. Y. Laws 1869, chap. 907.

the petitioners, which, among other things, stated that the persons signing said petition are a majority of the taxpayers whose names appear upon the last preceding tax list and assessment roll in said town. It was contended in behalf of the town that the petition failed to set forth that the petitioners were such a majority of the taxpayers by reason of the insertion of the word "representing," which, it was claimed, so far qualified the phrase "a majority of the taxpayers" following it, as to import that such majority did not themselves subscribe the petition, but did it only through the instrumentality of others who were such subscribers, and in the relation of agency represented such taxpayers in thus making the application. The court held adversely upon this contention, and that the petition, as made, was in compliance with the statute and gave jurisdiction to the county judge to entertain the proceeding.[1]

§ 478. Bonds issued after the passage of an act authorizing a change in their terms. — The act of 1871, amendatory of the act of 1869, changing the term for which bonds issued by towns in aid of railroads might run, has been held by the New York Court of Appeals to apply to bonds issued after it went into effect, in pursuance of a consent of taxpayers given and adjudicated upon before that time, and, as so construed, that the act was constitutional.[2]

[1] Town of Solon *v.* Williamsburgh Savings Bank. (1889) 114 N. Y. 122.

[2] Brownell *v.* Town of Greenwich, (1889) 114 N. Y. 518, Brown, J., dissenting. *Arguendo*, Vann, J., for the majority of the court, said: "In Syracuse Savings Bank *v.* Town of Seneca Falls, 86 N. Y. 317, it was held that the act of 1871 applied to proceedings regularly taken prior to its passage. In that case the proceedings were terminated in August, 1870, when the county judge made the adjudication and record, and appointed the commissioners, who delayed action until after May 12, 1871, when they subscribed for stock and issued the bonds. No further consent of the taxpayers was obtained. In Angel *v.* Town of Hume, 17 Hun, 374, the adjudication was made April 22, 1871, and the bonds were issued in February and July, 1872. In both of these cases it was held that the judgment of the county judge, based solely upon the consent of the taxpayers to bond pursuant to the act of 1869, was not nullified or avoided by the amendment of 1871. In neither of those cases had any taxpayer consented to such an issue of bonds, as the amended act gave the commissioners the discretion to issue. In Gould *v.* Town of Sterling, 23 N. Y. 456, the consents were obtained prior to September 29, 1852 (pp. 443, 445), while the bonds were issued in August, 1853 (p. 457). In the meantime an act had been passed authorizing the interest upon the bonds to be made payable on the first

§ 479. Rules as to the taxes collected for payment of bonds issued under New York statutes.— This was an action by a supervisor of a town in New York against the supervisors of the county to recover certain state and county taxes which had been collected of a railroad company which had been aided by the issue of bonds of this town under certain statutes of the state, and which it was claimed had been diverted by the county by the action of its board of supervisors and county treasurer from the use of the town to general county purposes, contrary to certain statutes of the state. The Court of Appeals, upon the question

days of January and July of each year, instead of March first, as was provided by the original bonding act. The only authorities cited to sustain the position that the act of 1871 is unconstitutional are People *v.* Batchellor, 53 N. Y. 128, and Horton *v.* Town of Thompson, 71 N. Y. 513. We do not consider either of them applicable to this case. The only constitutional questions involved in those cases were, in the former, whether the legislature could compel a town to become a stockholder in a railroad corporation by exchanging its bonds for stock without its consent in any way given; and, in the latter, whether the legislature could make a void bond valid after it had actually issued to a person who could not claim as a *bona fide* holder." Returning to the case at bar it was said: "In the case under consideration the consents had been duly given, and an adjudication duly made to that effect, when the amendatory act was passed. There was no want of power, therefore, to issue bonds, as the conditions precedent had all been complied with. The amendment did not extend to matters of jurisdiction, 'but to that which the legislature might have dispensed with the necessity of by the prior statute.' The bonding act would not have conflicted with the Constitution if it had contained no provision as to when the bonds should be made payable, but had left that to the discretion of the commissioners. The provision, therefore, so far as the Constitution is concerned, was immaterial, and could be modified, even retrospectively, at the discretion of the law-making power. In Williams *v.* Town of Duanesburg, 66 N. Y. 137, the court said: 'In this case the legislature could originally have authorized the bonds of the town * * * to be issued under the precise circumstances existing when they were issued; and if the acts of the commissioners have, by subsequent legislation, been ratified, it is equivalent to an original authority to do what has been done. The authorities as to the legislative power to validate, by subsequent legislation, acts done in assumed execution of a statute authority which has not been strictly followed are numerous and decisive.' People *v.* Mitchell, 35 N. Y. 551; Town of Duanesburg *v.* Jenkins, 57 N. Y. 177; People ex rel. Kilmer *v.* McDonald, 69 N. Y. 362; Tifft *v.* City of Buffalo, 82 N. Y. 204; Rogers *v.* Stevens, 86 N. Y. 623. If the legislature has power, after bonds have been issued, to correct irregularities of official action, without affecting the consents of the taxpayers previously given, its power to authorize a change in the form of the bond before it is actually issued, without impairing such consents, cannot well be denied."

of the rights of the town in such case, generally, said: "The right of towns that have issued bonds in aid of railroads, and which are still outstanding, to reclaim taxes collected from the railroad within the town, but diverted to general purposes, is well settled."[1] There was a Statute of Limitations as to such actions, and it appeared as to the claims embraced in this suit for certain years that the board of county supervisors, as organized, at certain dates had passed resolutions referring to the taxes for those years, in which they expressly stipulated and agreed not to interpose the defense of the Statute of Limitations to any sum found due the town on account of the taxes in question. The Court of Appeals held that this stipulation and agreement were within the power of the board of county supervisors.[2] The statutes of New

[1] Woods *v.* Board of Supervisors of Madison County, (1893) 136 N. Y. 403, 405, 406; citing Clark *v.* Sheldon, 106 N. Y. 104; Strough *v.* Supervisors, 119 N. Y. 212; Crowninshield *v.* Supervisors, 124 N. Y. 583; Kilbourne *v.* Supervisors, 62 Hun, 210.

[2] Ibid. The court said: "It is stated as a fact in the case agreed upon that the plaintiff, relying upon the validity of such resolutions, refrained from bringing an action in time for the recovery of the taxes for these years, which, but for such stipulations, he would have done. If the county, through its board of supervisors, can waive the statute like an individual, this would seem to be a writing signed by the party to be charged, and containing a sufficient acknowledgment of the debt and a promise to pay the same within the meaning of the Code. Code, § 395; Chemung Canal Bank *v.* Supervisors, 5 Den. 517; Shapley *v.* Abbott, 42 N. Y. 443; Anderson *v.* Sibley, 28 Hun, 16; Mosher *v.* Hubbard, 13 Johns. 510. Boards of supervisors represent the county in its corporate capacity and have power to bind it to the extent conferred by statute and when any act of such board is challenged as beyond its power, or not binding upon the county, resort must be had to the specific powers enumerated in the statute which such board may exercise. But in such cases the body is not confined to the exercise of the precise act contained in the grant of power, but, from the nature of the case as well as upon settled principles, it possesses and may exercise such incidental powers not expressly enumerated or mentioned in the statute, but which are fairly and reasonably necessary and proper in order to give effect to or carry out the powers expressly conferred. Dillon on Mun. Corp. § 89; Brady *v.* Mayor, etc., 1 Barb. 584; Supervisors *v.* Bowen, 4 Lans. 24. Boards of supervisors are expressly empowered by statute 'to examine, settle and allow all accounts chargeable against the county, and to direct the raising of such sums as may be necessary to defray the same.' It cannot be doubted that the board had power to settle and allow the plaintiff's claim and restore the money which had been appropriated to the benefit of the county at large, instead of investing or using it for the benefit of the town as required by the statute. Nor can it be doubted that in this suit the defendant could have most effectually waived the defense of the Statute of Limitations by honestly, and with-

York, providing for the bonding of towns in aid of railroads, direct the application of taxes assessed upon any railroad in a town toward the redemption of bonds issued by it in the construction of such railroad, and make it the duty of the county treasurer to purchase with such taxes the bonds of the town, or to otherwise invest the same and hold the investment as a sinking fund for the redemption of such bonds. Upon the petition of a taxpayer of a town to compel the county treasurer to apply such taxes in his hands as directed by the statute, the New York Court of Appeals held that a county treasurer, in his relation to such taxes, was not the agent of the county or town, but held them as a trust fund for the purpose expressed in the act, and any action on his part that diverted them from that purpose was illegal. Further, that any taxpayer of the town might apply to the county judge for an order compelling the county treasurer to execute the law in case of his refusal so to do, and it was the duty of the

out collusion, refusing to plead it. Having the power to audit it and settle the claim and to bind the county in that respect, it is difficult to discover any sound reason in law or in morals for the contention that the stipulation in question is not also within the scope of their necessary incidental powers. The board may have been in doubt as to their powers or duty to pay or audit, and by the stipulation it procured time and induced the plaintiff to delay legal proceedings. Under such circumstances, justice requires that the defendant be held bound by the stipulation in the same way as if made between individuals for a like purpose. It was said by CHURCH, Ch. J., in Buffalo *v.* Bettinger, 76 N. Y. 393, that 'a municipal corporation has public and private attributes, and its rights and duties are regulated accordingly. In protecting its property, in collecting its debts, and in general in transacting business of a private character, when not otherwise provided by statute, it may avail itself of the rights and remedies afforded to an individual.' The defendant has capacity to sue and be sued, to audit, settle, pay or compromise claims against it, and this fairly implies power to agree upon terms of payment and to waive by proper agreement the defense of the Statute of Limitations as to claims not barred. This power was exercised in this case for the purpose of relieving the county from actions at law in each year as the time for bringing such suit was about to expire, and we think the bar of the statute is thereby avoided. This result does not disturb the rule, which is conceded, that a county, through its board of supervisors, can exercise only such powers as are expressly conferred by statute, or such incidental powers, not expressly enumerated, as are necessary to carry out the express powers, and, moreover, it is supported by those general principles of equity and justice which are binding upon all corporations as well as upon individuals." As to the rights of a village as to such taxes, see Village of Oneida *v.* Board of Supervisors of Madison County, (1892) 136 N. Y. 269.

county judge to grant the order applied for. Further, in such proceedings, it was no defense that the county treasurer had paid over the fund to an officer of the town, or that the town had had the benefit of it for other town purposes. In this case it appeared that the transactions upon which a claim of the county treasurer, that he had paid over the fund to the town officers, was based, occurred during the pendency of the proceeding of the taxpayer against him before the county judge to compel him to comply with the statute. The Court of Appeals held that his refusal to obey the statute was not only without legal excuse, but was to be regarded as willful; and that he was chargeable with the fund, and also with interest upon it, as the town had been deprived of interest which it would have earned had the law been obeyed.[1] The Court of Appeals has, in another case, held that this statute requiring taxes collected on the assessed valuation of a railroad in a municipality which has issued bonds to aid in the construction of the railroad to be applied by the county treasurer to the purchase of such bonds, or to be invested as a sinking fund for their redemption, is not limited to the bonds originally issued; that where new bonds have been issued to retire and pay off the old ones, they are covered by the provision, as they represent in all respects the same debt.[2] The taxes collected on the assessed valuation of a railroad in a municipality which had issued bonds to aid in the construction of the railroad, instead of being used, as required by the statutes, by the county treasurer to purchase the bonds, or invested by him, having been applied by that officer to the payment of county obligations, the New York Court of Appeals held that the town had an equitable cause of action against the board of supervisors of the county to compel the levying and collection of a tax upon the taxable property of the county for the amount so misappropriated, to be paid to the treasurer and used as required by the statutes. And the fact that the municipality had presented its claim to the board of supervisors and demanded the levying and collection of the tax, and

[1] Clark *v.* Sheldon, (1892) 134 N. Y. 333; s. c., 32 N. E. Rep. 23. See Matter of Clark *v.* Sheldon, (1887) 106 N. Y. 104, in which the court sustained the constitutionality of the statutes under which this proceeding was had. See, also, Strough *v.* Supervisors, 119 N. Y. 212; Crowninshield *v.* Supervisors, 124 N. Y. 583.

[2] Barnum *v.* Board of Supervisors of Sullivan County, (1893) 137 N. Y. 179; s. c., 33 N. E. Rep. 162, affirming 62 Hun, 190.

that the demand had been refused, did not confine the remedy of the claimant to a *certiorari* to review the action of the board, or to a *mandamus* to compel a compliance with the demand. Upon the plea of the Statute of Limitations as a bar it was held that such a cause of action arose when the county treasurer appropriated the money to the payment of county obligations, and the burden was upon the county to show that the money was so misappropriated more than six years before the commencement of the action.[1]

§ 480. Power of town authorities as to aid bonds under Kansas statutes — for what time they may run.—As to the authority of a municipal township of Kansas to issue certain kinds of bonds in aid of a railroad, the United States Circuit Court of Appeals for the eighth circuit calls attention to these special provisions of the statute of that state authorizing subscriptions in aid of railroads, to wit: That one which requires a petition by two-fifths of the taxpayers, asking the county commissioners to submit to the township electors a proposition of subscription; such petition to designate the amount of the stock, "the terms of payment," and other conditions of the subscription; the proposition to be accepted by two-thirds of those voting at the election held for that purpose, and the bonds to have coupons attached "as may be required by the terms of said proposition;" the county commissioners to levy a tax "sufficient to pay the interest on such bonds as the same shall become due, and to create a sinking fund sufficient to pay such bonds at maturity," the principal of the bonds to be made payable "at any time that may be fixed in the proposition voted on," not exceeding thirty years. The section after this last declares, among other things, that to the said bond shall be attached coupons for annual installments of "the principal and interest accruing from time to time by the terms of the bonds." The Court of Appeals held that, in view of the prior provisions, the language quoted from the last section did not require that all bonds issued under the act should provide for annual payments on the principal, but merely that if the proposition voted on provided for such annual payments, coupons therefor should be attached, and the

[1] Kilbourne *v.* Board of Supervisors of Sullivan County, (1893) 137 N. Y. 170; s. c., 33 N. E. Rep. 159.

township had authority, by proper proposition, vote, etc., to issue bonds, the whole principal of which should not mature until thirty years.[1]

§ 481. Power of towns in Massachusetts as to aid bonds — their power in the sale of them.—In a rather recent action on contract to recover certain installments of interest on the bonds issued by a town in Massachusetts in aid of railroads, the Supreme Court of Judicature of that state referred generally to the statutes of the state with reference to bonding, etc., and then rendered their opinion as to the power of the towns of that state under those statutes in these words: "We can have no doubt that in this commonwealth the power given to these towns to raise these large or annual sums of money by loans, no conditions or restrictions being imposed, carried with it the power to issue bonds, a method which certainly enabled the towns to seek the best markets. It is, indeed, laid down as a sound doctrine of general application in 1 Dillon Mun. Corp. § 125 that 'express power to borrow money, perhaps in all cases, but especially if conferred to effect objects for which large or unusual sums are required, as, for example, subscriptions to aid railroads and other public improvements, will ordinarily be taken, if there be nothing in the legislation to negative the inference, to include the power (the same as if conferred upon a corporation organized for pecuniary profit) to issue negotiable paper with all the incidents of negotiability.' Many decisions are cited in support of this statement, but the recent decision in Merrill v. Monticello, 138 U. S. 673, is to the contrary. However it may be elsewhere, our decision rests upon the usage and the general course of legislation in this commonwealth." As to the regularity and validity of the bonds, it was said: "It is contended by the defendant that, even if the town had power to borrow money and issue the bonds therefor, the issue was irregular and invalid, because the bonds were delivered directly to the officers of the railroad company in exchange for the stock for which the town had subscribed, instead of being sold for money. The bonds appear to have been taken at par, and there has been no proof or suggestion, and, so far as we are aware, there is no reason to suppose that they would have brought more than par in the market. The

[1] Township of Washington *v.* Coler, (1892) 51 Fed. Rep. 362.

state got them at that rate. If the railroad company was willing to take them at their fair value, it would have been a vain and useless proceeding to require the towns to sell them in the market for cash and pay over the money to the railroad company. This was not necessary."[1]

§ 482. Power of towns in Mississippi as to aid bonds — for what time they may run.— A town in Mississippi, under the statute of March 25, 1871, of that state, authorizing the issue of bonds of counties, cities and towns in payment of subscriptions by the municipalities to the capital stock of a railroad company, issued such bonds maturing at from eleven to seventeen years. In an action by a holder of certain of these bonds and coupons thereon past due, in the demurrer to the declaration, it was claimed by the town that the bonds sued on, being payable more than ten years after their execution, were void. The Supreme Court of the United States affirmed the decision of the Circuit Court of the United States sustaining the demurrer to the declaration on this ground.[2]

[1] Commonwealth *v.* Williamstown, (1892) 156 Mass. 70, 73, 74. The court cited to the last statement, Commonwealth *v.* Commissioners of Allegheny, 37 Pa. St. 237, 241; Rogers *v.* Burlington, 3 Wall. 654, 666, 667. The court cited, also, various statutes and these additional cases: Chapin *v.* Vermont & Massachusetts Railroad, 8 Gray, 575; Edwards *v.* Marcy, 2 Allen, 486; Haven *v.* Adams, 4 Allen, 80; White *v.* Vermont & Massachusetts Railroad, 21 How. 575.

[2] Barnum *v.* Okolona, (1893) 148 U. S. 393. Mr. Justice SHIRAS, speaking for the court, declared the law of the case to be as follows: "That municipal corporations have no power to issue bonds in aid of a railroad except by legislative permission; that the legislature, in granting permission to a municipality to issue its bonds in aid of a railroad, may impose such conditions as it may choose; and that such legislative permission does not carry with it authority to execute negotiable bonds except subject to the restrictions and conditions of the enabling act, are propositions so well settled by frequent decisions of this court, that we need not pause to consider them. Sheboygan County *v.* Parker, 3 Wall. 93, 96; Wells *v.* Supervisors, 102 U. S. 625; Claiborne County *v.* Brooks, 111 U. S. 400; Young *v.* Clarendon Township, 132 U. S. 340, 346. Accordingly, if, in the present instance, the legislature of Mississippi, in authorizing the town of Okolona to subscribe for stock in a railroad company and to pay for the same by an issue of bonds, prescribed that such bonds should not extend beyond ten years from the date of issuance, such limitation must be regarded as in the nature of a restriction on the power to issue bonds. Norton *v.* Dyersburg, 127 U. S. 160; Brenham *v.* German American Bank, 144 U. S. 173, 188." There was a contention on behalf of the holder of the bonds that no such limitation was put by the enabling act on bonds issued by towns; that the restriction to a limit of ten years, contained in the fourth section of the act, was applicable only to the case of bonds issued by counties. To this the court said: "It is true that, in the fifth section of the act, which conferred the power on towns and cities to subscribe for railroad stock and pay therefor in bonds, no express provision is found as to the length of time during which the bonds shall run. As, however, the fifth section does provide that the bonds to be given by towns shall be issued 'in the same manner and with the like effect sufficient in amount to meet the total sum of their respective subscriptions for stock, as the boards of supervisors of the different counties are by this act authorized to do,' and that all 'bonds and coupons of interest issued by said mayor and selectmen shall be alike binding upon said towns respectively, in their corporate capacity, as the said bonds so issued by the said boards of supervisors shall be binding upon said counties respectively,' it seems plain that the legislative intent was that the bonds of the towns should be subject to the ten-year limitation contained in the fourth section. This is the fair and obvious import of the language used. The question involves the construction of the statute of Mississippi and has been decided by the Supreme Court of that state in the case of Woodruff *v.* Okolona, 57 Miss. 806, where it was held that bonds issued under that act, having more than ten years to run, were void, and where, in order to reach that conclusion, it was necessary to hold that the limitation of ten years for the running of the bonds, contained in the fourth section, was applicable to bonds issued by towns under the fifth section."

§ 483. Actions of bona fide holders on such bonds — what they need not show.— The Supreme Court of the United States has held that an instruction asked in an action by a holder of certain bonds issued by a town in New Jersey and exchanged for bonds of a railroad as authorized by a statute of that state, "that by the issue presented [the town pleaded *non est factum*] by the pleadings in the case, the burden of showing that he was a purchaser for value, or claims title through such a purchaser, was on the plaintiff," was properly refused.[1] Another instruction

[1] Montclair *v.* Ramsdell, (1882) 107 U. S. 147, 158. The court said: "The pleadings do not, of themselves, impose upon plaintiff the necessity of showing either that he, or any prior holder of the bonds, was a purchaser for value. As holder he is presumed to have acquired them in good faith and for value. Goodman *v.* Simonds, 20 How. 343; Murray *v.* Lardner, 2 Wall. 110; Shaw *v.* Railroad Co., 101 U. S. 557; Swift *v.* Smith, 102 U. S. 442. The plea of *non est factum* did not put in issue the fact that he was the holder. Legislative authority for an issue of bonds being established by reference to the statute, and the bonds reciting that they were issued in pursuance of the statute, the utmost which plaintiff was bound to show to entitle him, *prima facie*, to judgment was the due appointment of the commissioners and the execution by them, in fact, of the bonds. It was not necessary that he should, in the first instance, prove either that he paid value or that the conditions preliminary to the exercise by the commissioners of the authority conferred by statute were, in fact, performed before the

was asked in this case and refused, to wit: "If the evidence satisfies the jury that there were circumstances of fraud or illegality in the inception of the bonds or in the circumstances under which they were issued and disposed of by the commissioners, then the plaintiff cannot recover on the bonds without some proof that he purchased them for value, or gave some consideration for them." The counsel on behalf of the town contended that it was competent under the plea of *non est factum* to prove either fraud or illegality in the inception of the bonds, in order to remove the presumption of *bona fide* ownership for value which arises from the mere possession of the bonds, and thus compel plaintiff to show that *he* paid value for them; consequently the foregoing instruction should have been given. The Supreme Court of the United States held that it was properly refused.[1]

bonds were issued. The one was presumed from the possession of the bonds; and the other was established by the statute authorizing an issue of the bonds, and by proof of the due appointment of the commissioners and their execution of the bonds, with recitals of compliance with the statute. So we have often ruled in numerous cases with which the profession are familiar and which need not be cited." Illustrations of who are not *bona fide* purchasers of bonds of a town, Lansing *v.* Lytle, 38 Fed. Rep. 204. A transferee of such bonds in an action brought against him for their surrender and cancellation has imposed upon him the burden of showing that he or the one under whom he claims was a *bona fide* purchaser. Lytle *v.* Lansing, 147 U. S. 59; citing Stewart *v.* Lansing, 104 U. S. 505.

[1] Montclair *v.* Ramsdell, (1882), 107 U. S. 147. The court said: "'[The refusal to give this instruction] was proper for the reason, if there were no other, that it required the jury, if they believed either fraud or illegality in the inception of the bonds to have been established, to find for the township, unless the plaintiff proved that *he* purchased for value or gave some consideration for them. Such is not the law; for if any previous holder of the bonds in suit was a *bona fide* holder for value, the plaintiff, without showing that he had himself paid value, could avail himself of the position of such previous holder. * * *" This question was directly adjudged in Commissioners *v.* Bolles, 94 U. S. 104. One of the issues there was whether the plaintiff was a *bona fide* holder of certain municipal bonds. After stating that the legal presumption was that they were, the court, speaking by Mr. Justice Strong, said: "But the plaintiffs are not forced to rest upon mere presumption to support their claim to be considered as having the rights of purchasers without notice of any defense. They can call to their aid the fact that their predecessors in ownership were such purchasers. To the rights of those predecessors they have succeeded. Certainly, the railroad company paid for the bonds and coupons by paying an equal amount of their stock, which this county now holds; and nothing in the special facts found shows that the company knew of any irregularity or fraud in their issue." The court proceeded: "And still more; the contractor for building the railroad received the bonds from the county in payment for his work, either in whole or in part, after his work had been completed. There is no pretense that he had notice of anything that should have made them doubt their validity. Why was he not a *bona fide* purchaser for value? The law is undoubted that every person succeeding him in the ownership of the bonds is entitled to stand upon his rights." The court in this case then resumed: "When the instruction [here] was asked, the proof was that the bonds had been issued by the commissioners, and exchanged with the railroad company for a like amount of the company's income bonds. That exchange was a substantial compliance with the statute. It was made under a contemporaneous agreement between the commissioners, the railway company and certain trustees, mutually selected, whereby the bonds passed upon the exchange, under the control of those trustees, and were deposited in the Union Trust Company, to be surrendered — ten thousand dollars at a time — only as the work of constructing the railroad progressed, to the company or the contractor on their order. The receipt of the trust company shows that it agreed to deliver them to the contractor or his agents or assigns, on the joint order of the trustees or any two of them, and it was proven that the bonds were delivered to the contractor or upon his order between May 10, 1870, and August 4, 1871. The road was constructed as contemplated, and the income bonds of the company remained in the hands of the commissioners or of some of them. Whether those bonds ultimately proved to be of any value, is of no consequence as between the township and the plaintiff. It thus appears that when the court was asked to give an instruction upon the basis that the plaintiff could not recover, unless it was proven that he paid value for the bonds, it was established beyond question that the bonds had previously passed into the hands, or become pledged for the benefit, of the contractor who built the road. He acquired an interest, or a lien, on the bonds, to secure payment of the amount due him for his work and labor. He, therefore, became a holder for value in the sense that he paid real, in contradistinction from apparent, value, without notice of any fraud or illegality affecting the bonds. Story on Notes, § 195; Railroad Company *v.* National Bank, 102 U. S. 14; Byles on Bills, 117. No evidence was introduced or offered which in any degree impeached his good faith, or proved knowledge on his part that the preliminary conditions prescribed by statute had not been fully performed. The character of the bonds as negotiable securities,

§ 484. Bonds absolutely void — effect upon holders.—The Supreme Court of Illinois has held that where bonds of a municipal corporation are issued without any power or authority in law, as under what purported to be a law, but which was not passed in the constitutional mode, they are absolutely void, no matter in whose hands they may be; but if the legal power or authority to issue them existed, but was defectively or irregularly executed, they are only voidable, and an innocent holder may collect them. Where they are void, no subsequent act or recognition of their validity by the municipal authorities can estop the taxpayers from

denying their legality.[1] Negotiable bonds which have been issued without statutory authority in payment of a subscription to the stock of a railroad company, which subscription a town, in pursuance of statutory authority, makes, are absolutely void, and no suit can be maintained on them on the theory that they are valid as non-negotiable instruments.[2]

free from defenses which might have been available as between the original parties, was established by their being pledged for the benefit of the contractor. So that, even if there was fraud or illegality in the inception of the bonds (apart from such illegality as would have made them absolutely void by whomsoever held), a defense upon that ground would not have been good against the contractor, and consequently is not available against the plaintiff. The latter, in virtue of the new and independent title derived from or traced to a prior *bona fide* holder for value, could stand upon the rights of such holder." The questions of pleading and rules of evidence in actions on town aid bonds are very fully discussed in Brown *v.* Point Pleasant, 36 W. Va. 290.

[1] Ryan *v.* Lynch, (1873) 68 Ill. 160. As to this distinction, as repeatedly recognized, the court cited Clark *v.* Board of Supervisors of Hancock County, 27 Ill. 308; Johnson *v.* Stark County, 24 Ill. 75; Schuyler County *v.* The People, 25 Ill. 185; Board of Supervisors *v.* Weider, 64 Ill. 427; Marsh *v.* Fulton County, 10 Wall. 683. In a later case (Barnes *v.* Lacon, [1877] 84 Ill. 461) the court adhered to their ruling in Ryan *v.* Lynch, 68 Ill. 160, and as the bonds, in their opinion, were absolutely void, held that the holder could not recover on them. They said: "This rule is well settled in this and other courts. The position of [the plaintiff] is, however, untenable upon another ground. The bonds contain a recital on their face that they are issued in payment of a subscription made by the town of Lacon by virtue of a vote of a majority of the voters at a special election held in said town on the 22d day of December, 1868. This was notice to the purchaser, when he was informed by a recital in the bonds that they were issued in pursuance of a vote of the people at an election held at a special time, and there was no law in existence authorizing the election to be held at that time. As he cannot claim to be ignorant of what the law was, he was bound to take notice of the illegality of the election."

[2] Dodge *v.* City of Memphis, (1892) 51 Fed. Rep. 165; citing Mayor *v.* Ray, 19 Wall. 468; Hitchcock *v.* Galveston, 96 U. S. 350; Little Rock *v.* Merchants' Nat. Bank, 98 U. S. 308; Wall *v.* Monroe Co., 103 U. S. 78; Hill *v.* City of Memphis, 134 U. S. 198; s. c., 10 Sup. Ct. Rep. 562; Merrill *v.* Monticello, 138 U. S. 673; s. c., 11 Sup. Ct. Rep. 441. Referring to these cases, THAYER, J., said: "They show, no doubt, that when a municipal corporation sells bonds which are void, and receives the money, it may be compelled to restore it in an action for money had and received. So, when a municipal corporation is authorized to purchase property for any purpose, or to contract for the erection of public buildings, or for any other public work, and it enters into such authorized contract, but pays for the property acquired or work done in negotiable securities, which it has no express or implied power to issue, it may be compelled to pay for that which it has received in a suit brought for that

§ 485. When a curative act of the legislature will not validate them.—In a case before the Illinois Supreme Court, where it was held that a subscription of a certain sum to the stock of a railroad company, being voted in a town meeting without authority, was void and conferred no power on the town authorities to issue railroad bonds, the effect of a certain act of the legislature, the intention of which was to make the subscription binding upon the town, was fully considered by the court. The question before the court was whether the legislature could create a debt against a town and require the town to assess a tax for its payment. The object of the act being to compel the town to issue bonds for railroad stock independently of its own wishes, as viewed by the court, the act was held to be one violative of the Constitution and of no effect.[1] There was a contention in the case that the legislature might have authorized the town supervisor and town clerk, as the corporate authorities of the town, to subscribe to the stock of the railroad corporation and issue township bonds therefor without a vote of the people, and that the curative act was to be considered as giving them that power, which they had duly exercised. The court held adversely to this contention.[2]

purpose. In no case, however, does it appear that a suit has been sustained on a void bond treating it as non-negotiable and as something entirely different from what the parties intended it should be."

[1] Marshall *v.* Silliman, 61 Ill. 218. The court referred to the provision of the then existing Constitution that "the corporate authorities of counties, school districts, cities, towns and villages may be vested with power to assess and collect taxes for corporate purposes, such taxes to be uniform in respect to persons and property within the jurisdiction of the body imposing the same," and the rulings of the court previously construing this clause in Harward *v.* The St. Clair & Monroe Levee Drainage Co., 51 Ill. 130; People ex rel., etc., *v.* The Mayor of Chicago, 51 Ill. 30; Hessler *v.* Drainage Comrs., 53 Ill. 110, and Lovingston *v.* Wider, 53 Ill. 302, as settling the doctrine that, under that Constitution the legislature could not compel a municipal corporation to incur a debt for merely local purposes against its own wishes.

[2] Marshall *v.* Silliman, (1871) 61 Ill. 218. The court distinguished Town of Keithsburg *v.* Frick, 34 Ill. 420, which was relied upon to support this contention, in these words: "It was said in that case that the legislature might grant that power to the trustees of a town, if it thought proper to do so, without taking a vote of the people. We do not dissent from that position, but it does not aid the appellees in the present case. The town supervisor and clerk who issued the bonds do not represent a township as the board of trustees represent an incorporated town or the common council represent a city. The super-

§ 486. Effect of curative act of New York.— The effect of a curative act of the state of New York upon the bonds issued by a town in that state, under its laws, in aid of a railroad, being before the United States Supreme Court, this court, by reason of a judgment rendered in the Court of Appeals of New York that this act, in its main features, was unconstitutional, and this judgment, the town contending, being conclusive upon the Supreme Court, very fully considered the statutes of the state of New York with reference to such municipal aid. After a review of the decisions of the courts of New York pertinent to the question, they held that the subsequent act of the legislature effectually cured the defects in connection with the original issuing of

visor and town clerk are but a part of the corporate authorities. They have no power of taxation nor power of themselves to bind the city in any way. The case of Lovingston *v.* Wider, 53 Ill. 302, may again be cited. We said there that the police commissioners were not the corporate authorities of East St. Louis, as they had not been elected by the people of the city nor appointed in any manner to which the people had given their consent, and, therefore, the legislature could not give them the power of taxation by creating a debt binding upon the city. So of the supervisor and clerk. Though elected by the people, they were not elected for the purpose of creating a debt or imposing a tax, and the legislature could not clothe these two officers, without the consent of the people, with a discretionary power of taxation or of creating a debt, because they are not by themselves the corporate authorities in the sense of the Constitution. But even if these two officers could be recognized as the corporate authorities, they cannot be said to have voluntarily incurred this debt on behalf of the town. The act gave them no discretion. It declares the subscription shall be binding and may be collected. It did not authorize the corporate authorities to subscribe to the stock or not, as they should think proper, but declared that an illegal vote should be a valid subscription, and left to the town authorities only the ministerial function of executing the behest of the legislature. Counsel for appellees claim that this case is like that of Cowgill *v.* Long.15 Ill. 202. There is, however, a broad distinction. The tax in that case was a valid tax, and when the court say in their opinion that it was improperly voted in July, they evidently mean merely that it was improperly voted in that month for the purpose of collection during the current year. The tax was legally imposed, and the only question decided by the court was that the subsequent act of the legislature legalizing the steps by which the tax was illegally certified to the County Court and placed in the course of collection during that year was so far effectual that the tax could be collected by virtue of the act. The act dealt with a subject entirely under the control of the legislature, namely, the subject of remedy. The question before the court was very different from the ratification of a void tax by retrospective legislation, which the legislature could not of its own power impose prospectively."

these bonds, and that they were valid obligations in the hands of the holder in this case.[1]

§ 487. Township bonds under South Carolina laws made a legal indebtedness by subsequent legislation.— The Supreme Court of South Carolina, by a majority of the court, having held in 1888 that township bonds, issued in aid of rail-

[1] Thompson *v.* Perrine, (1880) 103 U. S. 806. The cases reviewed by the Supreme Court in the opinion rendered by Mr. Justice HARLAN were Bank of Rome *v.* Village of Rome, 18 N. Y. 38; People *v.* Mitchell, 35 N. Y. 551; People *v.* Batchellor, 53 N. Y. 128; Town of Duanesburgh *v.* Jenkins, 57 N. Y. 177; Williams *v.* Town of Duanesburgh, 66 N. Y. 129; Clark *v.* City of Rochester, 13 How. Pr. 204. The court considered Horton *v.* Town of Thompson, 71 N. Y. 513, not binding upon it, and gave reasons why it was not. In Thompson *v.* Perrine, *supra*, as to the rights of the holders, it was said: "It is, therefore, an immaterial circumstance that the recitals in the bonds may have furnished notice that they were issued originally in violation of the statute. That was the very difficulty which the act of 1871 was designed to remove, and, as matter of law, it was removed, if regard be had to the settled doctrines of this court, or to the decisions of the highest court of the state, rendered previously to, and which were unmodified at, the passage of that act. It results that from that moment the bonds, by whomsoever held, whether by the railroad company or by others, became binding obligations upon the town, as much so as if they had originally been sold and their proceeds invested in the stock of the railroad company, as required by the acts of 1868 and 1869. If the rights of those holding the bonds were in any degree affected by the subsequent decision in People *v.* Batchellor, 53 N. Y. 128, the later decision in Town of Duanesburgh *v.* Jenkins, 57 N. Y. 177, restored the law, so far as the courts of New York were concerned, as it undoubtedly was declared to be at the time the act of 1871 was passed. The defendant in error acquired the bonds in suit in 1875, before the decision in Horton *v.* Town of Thompson, 71 N. Y. 513, and when, according to the principles announced in Town of Duanesburgh *v.* Jenkins, and many prior cases in the Court of Appeals, the act of 1871 must have been sustained as a valid exercise of legislative power. He purchased them for value at public auction in the city of New York, without notice of any defense thereto or of the pendency of any suit involving their validity. If the recitals in the bonds gave notice that the acts of 1868 and 1869 forbade their exchange for stock and required them to be sold and their proceeds invested in such stock, the purchaser is also presumed to have known, not only that such exchange had been legalized by the act of 1871, but that the authority of the legislature to pass that act was sustained by the decisions of the highest court of the state, rendered prior to its passage. His rights, therefore, should not be affected by a decision rendered after they accrued, which decision is in conflict with the law as declared not only by this court in numerous cases, but by the highest court of the state, at and before the time he purchased the bonds."

roads to be constructed through those townships, were invalid,[1] the legislature of that state in December, 1888, passed an act to provide for the payment of township bonds issued in aid of railroads in that state.[2] Certain bonds of a county of that state, executed before the passage of this act, had been placed in the hands of a trust company, but before they could be delivered to the parties entitled it was necessary that the engineer of the road should certify as to the completion of the road, and then the chairman and clerk of the board of county commissioners of that county were to affix their signatures to the certificate of the engineer. The engineer had given the certificate required by him, but the county officials above mentioned refused to affix their signatures. The parties entitled to these bonds thereupon petitioned the Supreme Court of the state for a writ of *mandamus* to compel these county officials to affix their signatures to the engineer's certificate, and thus enable these petitioners to have the bonds delivered to them. The Supreme Court dismissed the petition, holding that where a township voted a subscription to a railroad under an unconstitutional statute, and the county commissioners, as the agents of such township, issued bonds in payment therefor, and the county commissioners, assuming to act as such agents, made a contract with a trust company, whereby the trust company took possession of said bonds and agreed to deliver them to a construction company whenever the engineer of the railroad company certified that the railroad was completed through such township, and when this certificate was countersigned by the chairman of the board of county commissioners, attested by the clerk, the subscription, the issue of the bonds and the trust indenture being all unauthorized and void, *mandamus* would not lie after the railroad had been completed to compel such chairman to countersign, and such clerk to attest his signature to the certificate of the chief engineer that the road had been so completed.[3] The Supreme Court of South Carolina, in another peti-

[1] See Floyd *v.* Perrin, 30 S. C., 1; s. c., 8 S. E. Rep. 14. McGowan, J., dissented.

[2] See 20 St. at Large (S. C.), 12.

[3] State ex rel. C. C. & C. R. Co. *v.* Whitesides, (1889) 30 S. C. 579. McGowan, J., said: "I concur, the meaning of the opinion of the court being that there is no necessity for the issue of any new bonds; but 'the debt' fixed upon the several townships by the act of 1888 shall be represented by the bonds heretofore issued, to be paid according to the provisions of the act; and I am authorized to say that such is the view of the other members of the court." See Massachusetts & S. Const. Co. *v.* Cane Creek Tp., (1891)

tion for *mandamus* as to these township bonds, held that *mandamus* would not lie to compel a county treasurer to pay out money on a coupon of a railroad aid bond, when the only constitutional law that recognized such bonds and its coupons as a debt declared that no tax should be levied to pay interest on such debt until the railroad had been completed, and that all taxes theretofore collected for that purpose should be refunded to the taxpayers; and where no tax had been, or could have been, collected since the railroad was completed, the court in this case held that the act of 1888,[1] providing for the payment of township bonds in aid of railroads in that state, was not intended to validate a previous statute which this court had pronounced unconstitutional, nor to legalize acts done thereunder, but to impose upon consenting townships a debt which they had vainly attempted to impose upon themselves under such unconstitutional statute.[2] In a suit upon the bonds in aid of a railroad, issued by

45 Fed. Rep. 336, referring to South Carolina township bonds, holding that where township bonds are declared invalid by the courts, and the legislature afterwards passes an act providing for the payment of such bonds, the debt represented by the bonds is incurred at the date of such act.

[1] See 90 St. at Large (S. C.), 12.

[2] State ex rel. Dickinson *v.* Neely, (1889) 30 S. C. 587; s. c., 9 S. E. Rep. 664. The court sustained the constitutionality of the act of 1888. After calling attention to the distinction between the two classes of power of the legislature, the one which it exercises at its own sovereign will, the other which it delegates to some subordinate agency, to be exercised by such agency at its will, within the prescribed limits, it is said: "Bearing these distinctions in mind, it must be obvious that when this court decided in Floyd *v.* Perrin, 30 S. C. 1, that the act purporting to delegate power to a township to levy a tax for a purpose other than a corporate purpose was unconstitutional, it did not touch the question whether the legislature might not, by the exercise of *its own* power, impose a tax for the same purpose for which it had, without constitutional authority, attempted to delegate the power to certain townships. That decision rested on the ground that as the purpose for which the legislature attempted to delegate to the townships the power of taxation was not a corporate purpose, the act purporting to delegate such power was without constitutional authority. No such question is presented or can arise in this case. The only question here is whether the legislature can, by the original exercise of its own power of taxation, impose a tax on the property within the boundaries of Cherokee township for the purpose of contributing to the construction of a railroad which passes through said township. The proposition that the construction of a railroad is such a public purpose as to warrant the levy of taxes to aid in building it is too well settled by the very decided weight of authority to admit of further discussion, although, if the question were an open one, its correctness might well be disputed. So, too, it seems to be settled by the weight of authority that the legisla-

this township of South Carolina, it was held in the federal court that the statute of that state of December, 1888 (20 Stat. [S. C.] 12), declaring all township bonds theretofore issued in aid of railroads to be a debt of the township, authorizing the levy of a tax to pay it, and providing that the bonds might be used as evidence of the amount and character of such debt, impressed such debt on the township *proprio vigore*, and it was liable therefor, although the act authorizing the issue of the bonds was unconstitutional and the bonds void; as to the interest, it was held that where an interest coupon covered a period before and after the completion and acceptance of the road, only so much of the interest as was earned after such completion could be recovered under the statute of December, 1888, which provided that no tax should be levied to pay any interest which may have accrued on such bonds prior to completion and acceptance of the road. There was a further ruling that voluntary payments made upon invalid coupons, prior to completion and acceptance of the road, could not be set off against those maturing afterwards.[1]

ture may not only delegate this power of levying taxes to aid in the construction of a railroad to municipal corporations, but may also, by the exercise of its original power of taxation, directly impose such tax upon any territorial division of the state, to aid in the construction of a railroad supposed to be of special advantage to the people residing within such territorial division, provided a majority of those people have signified their assent to the imposition of such a tax. Indeed, some of the authorities hold that the tax may be imposed without the consent of the inhabitants of the territorial division upon which the tax is imposed. But we are not prepared to go to that extent. What is said in the opinion of the chief justice in the case of State *v.* Whitesides, 30 S. C. 579, 584, 585, is not to be regarded as a decision that such a tax may be imposed directly by the legislature without the consent of the people of the particular locality to be affected thereby, but simply as a statement of the fact that some of the authorities go to that extent. Except for governmental purposes proper, we do not think that the legislature has the power to impose a tax upon the people of any particular locality or territorial subdivision of the state without their consent. In this case, however, such consent was given, and that is the avowed basis upon which the act of 1888 rests. It is argued, however, that such consent has only been manifested by an election held without authority of law, and hence should not be regarded. It seems to us that it is not at all material how the assent of the people has been given. All that was necessary was that the legislature should be satisfied that consent had been given, and the terms of the act, especially the preamble, show plainly that they were notified of that fact."

[1] Granniss *v.* Cherokee Township of York County, (1891) 47 Fed. Rep. 427.

§ 488. An Ohio statute as to town aid held unconstitutional.— The Supreme Court of the United States has held that the act of the legislature of Ohio of April 9, 1880, authorizing townships having a population of 3,683, under the census of 1870, "to build railroads and to lease or operate the same," and "to borrow money" as a fund for that purpose, and "to issue bonds therefor in the name of said township," is repugnant to the provisions in the State Constitution, that "the general assembly shall never authorize any county, city, town or township, by vote of its citizens or otherwise, to become a stockholder in any joint-stock company, corporation or association whatever, or to raise money for, or loan its credit to or in aid of, any such company, corporation or association," and the bonds of such a township, issued under the supposed authority of that act, were held to be void.[1] The United States Circuit Court for the northern district of Ohio, upon the case being remanded to the court by the United States Supreme Court, followed the latter and held the act unconstitutional and the bonds void.[2]

§ 489. Miscellaneous rules as to town aid bonds.— The issuing of township bonds to aid in constructing within its limits the depots and side tracks of an existing railroad, has been held to be authorized by the act of Kansas authorizing townships with other municipal corporations "to issue bonds for the purpose of building bridges, aiding in the construction of railroads, water power or other works of internal improvement," etc.[3] Negotiable bonds made by a township in Kansas, under legislative authority, reciting that they were issued "for the purpose of aiding internal improvements in said townships," have been held valid in the hands of a holder for value, notwithstanding they had in fact been issued to aid in the improvement of a water power, and the erection of a water mill owned by private persons.[4] The *bona fide* purchaser of municipal bonds is under no obligation to look beyond the action of the persons or tribunal authorized by law to determine the result of an election held for the purpose of ascertaining whether the municipality should issue its bonds in

[1] Pleasant Township *v.* Ætna Life Insurance Co., (1891) 138 U. S. 67; s. c., 11 Sup. Ct. Rep. 215.

[2] Ætna Life Ins. Co. *v.* Pleasant Township, (1893) 53 Fed. Rep. 214.

[3] Rock Creek Township *v.* Strong, 96 U. S. 271.

[4] Guernsey *v.* Burlington Township, 4 Dill. 372.

aid of an object authorized by law, as such action is conclusive.[1] A township in Michigan had voted railroad aid bonds with a condition precedent to the delivery of the bonds that the road should not only be in running order, but an equivalent amount of the company's stock should be delivered to the township treasurer. Before this was done a new township was set off from the one which voted the bonds. The Supreme Court of that state held that until the exchange of bonds for stock was made there were no contract relations with the railroad company, and that even if the bonds had been valid, the new township would not be bound by a judgment against the old township for the amount of the bonds.[2] Attaching conditions to the signatures to a petition for the issue of railroad aid bonds will not necessarily vitiate the petition.[3]

[1] Rock Creek Township *v.* Strong, 96 U. S. 271.

[2] Beeman *v.* Black, 49 Mich. 598.

[3] Town of Andes *v.* Ely, 15 Sup. Ct. Rep. 954. A case holding a town estopped to set up the defense of *ultra vires* as to bonds which were regular upon their face and purported to have been issued in accordance with the act of the legislature authorizing them, Town of Brewton *v.* Spira, (Ala.) 17 So. Rep. 606. In Linn *v.* Chambersburgh Borough, (1894) 160 Pa. St. 511, a bill in equity to restrain the borough from undertaking the erection of an electrical plant, on the ground that the borough indebtedness would be increased beyond the constitutional limit, it was held that the burden was on the plaintiff to prove that the indebtedness would be necessarily increased to an amount exceeding the legal limit. Railroad aid bonds held not invalidated in the hands of a *bona fide* holder in Union Bank *v.* Board of Comrs. of Town of Oxford, (N. C.) 21 S. E. Rep. 410. As to the power of the legislature under a constitutional provision that the legislature may permit municipal corporations to assess and collect taxes for corporate purposes only, to authorize such corporations to issue bonds in aid of railroad companies, see Town of Darlington *v.* Atlantic Trust Co., 68 Fed. Rep. 849. See, also, Atlantic Trust Co. of New York *v.* Town of Darlington, 63 Fed. Rep. 76. The Supreme Court of South Carolina has held a provision in an act of the legislature allowing female adults, owning $100 worth of taxable property within the corporate limits of the town, to vote at an election to be held in the town upon the question of issuing town bonds in aid of a railroad to be valid as within the power of the legislature. Woodley *v.* Town Council of Clio, (S. C. 1895) 22 S. E. Rep. 410, following Wilson *v.* City Council, 39 S. C. 397; s. c., 17 S. E. Rep. 835; approved in 40 S. C. 290; s. c., 18 S. E. Rep. 792.

CHAPTER XXV.

BONDS AND COUPONS — PRIVATE COPORATIONS.

§ 490. Bonds of private corporations, generally.
491. Meeting of stockholders to authorize the issuance of bonds — when legally held.
492. Interest on bonds — what rate, etc.
493. When principal becomes due.
494. Bonds — when "issued" under Wisconsin statute.
495. When a mortgage trustee should countersign bonds.
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497. Validity of bonds as affected by statutory or constitutional provisions.
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500. Bondholders — when bona fide holders and when not — the rights of such.
501. Holders of income bonds — rules as to an accounting with them.
502. Detached, uncanceled coupons — rules governing.
503. Actions on coupons — rules governing.
504. Guaranty of bonds of one corporation by another — rules.
505. Lease of a bonded railroad — when lessee is not bound on the bonds.

§ 490. Bonds of private corporations, generally.— Private corporations, in the conduct of their business, are vested with power to give, as obligations, their bonds as a means of borrowing money for their legitimate business purposes, or in payment of debts incurred in carrying out the purposes of their creation, unless there be some restriction upon them by statute.[1] These bonds are known, generally, as coupon bonds, because attached

[1] Peoria & Springfield R. R. Co. *v.* Thompson, 103 Ill. 187; Brown *v.* Maryland, 62 Md. 439; McLane *v.* Placerville & Sacramento Valley R. R. Co., 66 Cal. 606; Mead *v.* New York, Housatonic & Northern R. R. Co., 45 Conn. 199; Kelly *v.* Trustees, etc., 58 Ala. 489; Da Ponte *v.* Northern Pac. R. R. Co., 21 Blatchf. 534; Coe *v.* Columbus, Piqua & Ind. R. R. Co., 10 Ohio St. 372; Commonwealth *v.* Smith, 10 Allen (Mass.), 448; Craven *v.* Atlantic & North Carolina R. R. Co., 77 N. C. 289; Miller *v.* New York & Erie R. R. Co., 18 How. Pr. 374; Dana *v.* Bank of the United States, 5 Watts. & Serg. 223; McMasters *v.* Reed, 1 Grant's Cas. 36; Hubbard *v.* New York & Harlem R. R. Co., 36 Barb. 286. As to the power and right to issue income bonds, see Garrett *v.* May, 19 Md. 177.

and connected with them are usually interest coupons, for the terms at which the interest on the bonds is to become due; mortgage bonds, or bonds secured by mortgage or trust deed of the property of the corporation to a trustee for the bondholders; income bonds, secured by a mortgage of the income of the corporation, and debenture bonds. These bonds are usually made payable to bearer, and are negotiable, passing generally by delivery.[1] The statements in a certificate accompanying a bond that it is secured by a mortgage must be construed with the bond and mortgage as a part of the same security.[2] Bonds of a corporation chartered to build a canal that contained recitals that they should have preference over all debts to be thereafter contracted, and that, in default of payment of interest, the holder of the bonds might enter into the possession of the tolls, water rates and other incomes of the company, and might apply for the appointment of a receiver, have been held by the United States Supreme Court in effect to constitute a mortgage, and the holders of the bonds entitled to the relief usually granted in case of a mortgage.[3] The effect of the provisions of the Civil Code of California upon the bonds and mortgage of a railroad company was considered in a case, and it was held that, in a bond payable at a fixed date, a provision that the obligor may, at its option, redeem the

[1] Ide *v.* Passumpsic & Connecticut Rivers R. R. Co., 32 Vt. 297: Edwards *v.* Marcy, 2 Allen, 486; White *v.* Vermont & Massachusetts R. R. Co., 21 How. 575; Morris Canal & Bkg. Co. *v.* Fisher, 9 N. J. Eq. 667; Carr *v.* Le Fevre, 27 Pa. St. 413; Chapin *v.* Vermont & Massachusetts R. R. Co., 8 Gray, 575; Langston *v.* South Carolina R. R. Co., 2 S. C. 248; Hubbard *v.* New York & Harlem R. R. Co., 36 Barb. 286; Brainerd *v.* New York & Harlem R. R. Co., 25 N. Y. 496; s. c., 10 Bosw. 332; Dinsmore *v.* Duncan, 57 N. Y. 573; Welch *v.* Sage, 47 N. Y. 143; Hodges *v.* Shuler, 22 N. Y. 114; Virginia *v.* Chesapeake & Ohio Canal Co., 32 Md. 501; Junction R. R. Co. *v.* Cleneay, 13 Ind. 161. As to formalities of bonds, see Hendee *v.* Pinkerton, 14 Allen, 381; Allen *v.* Sullivan R. R. Co., 32 N. H. 446; Royal Bank of Liverpool *v.* Grand Junction R. R. & Depot Co., 100 Mass. 444; Chilton *v.* People, 66 Ill. 501; Bates *v.* Boston & N. Y. Central R. R. Co., 10 Allen, 251. When a *bona fide* purchaser of such bonds has a right to presume the requirements of a statute as to the execution of bonds have been complied with, see Connecticut Mut. Life Ins. Co. *v.* Cleveland, Columbus & Cincinnati R. R. Co., 41 Barb. 9. That the board of directors and president of the corporation have power without the concurrence of the stockholders to authorize the issue of bonds and mortgage, see Hodder *v.* Kentucky & Great Eastern Ry. Co., 7 Fed. Rep. 793.

[2] Benjamin *v.* Elmira, Jefferson & Canandaigua R. R. Co., 49 Barb. 441.

[3] White Water Valley Canal Co. *v.* Vallette, 21 How. 414.

same before maturity at any date when the semi-annual interest is due, did not render the bond so uncertain, as to time or amount, as to deprive it of its negotiable quality under the provisions of the Civil Code of California, sections 3087–3089, 3091, 3093. The constitutional provision of California that the stock and bonded indebtedness of corporations shall not be "increased" without the consent of the person holding the larger amount of the stock, does not apply to the first creation of bonded indebtedness.[1] It was found in an Illinois case, an action to annul certain bonds as *ultra vires* the railway corporation to issue, that the president and general manager of the corporation, without any authority, used the bonds which came into his hands to pay debts of other corporations which were under his control, and "not in any way about the construction, equipment or operation" of the railway corporation, and that the bonds were acquired by the holders with full knowledge that they had been misapplied in the manner they were. These findings the Supreme Court of the state held to exclude the hypothesis that the corporation, the debts of which were paid with the bonds, might have agreed to construct or equip the road in part, and were sufficient to support the decree declaring the bonds null and void as against the railway corporation.[2] A traffic contract had been made by a railway corporation, which had executed certain bonds payable in thirty years, with another railway corporation, agreeing that it should retain the former's share of the earnings and pay them over semi-annually to a trustee, to be applied to the ultimate redemption of the bonds. The contract, by its terms, was to continue for thirty years, "or for so long a time as will be sufficient to provide a fund large enough to redeem all of said bonds." The agreement was indorsed on the bonds. This agreement was held in a federal court not to give the corporation issuing the bonds the right to pay off the bonds as soon as a fund sufficient for that purpose had accrued and before the expiration of the thirty years.[3] A construction company, employed by a railroad corporation to build its track under an agreement, was to have issued to it by the railway corporation bonds of the latter to a certain amount

[1] Union Loan & Trust Co. *v.* Southern California Motor Road Co., (1892) 51 Fed. Rep. 840.

[2] City of Chicago *v.* Cameron, 120 Ill. 447; s. c., 11 N. E. Rep. 899.

[3] Chicago & Iowa R. Co. *v.* Pyne, 30 Fed. Rep. 86.

per mile of track, in installments, as sections of the work should be completed. The bonds of the railroad corporation, by a subsequent agreement, were delivered in advance of the building of the track, the construction company agreeing to take care of and pay all interest accruing before the road was in condition for traffic, and the railway corporation agreed to reimburse the construction company for all interest paid, not properly chargeable to it, out of the first earnings of the road. A federal court held that the proper construction of the contract was that the construction company was only bound to pay interest on so many of the bonds as it received and used to which it was not entitled under the construction contract.[1] That it was known to the executive committee of the directors of a corporation that a purchaser of its mortgage bonds purchased them under a belief that the proceeds were to be used for a particular purpose, has been held in New York not sufficient to bind the corporation to a trust limiting the use of the proceeds of the bonds sold.[2] The charter of a consolidated corporation recited the uses to which money to be derived from the sale of its bonds was to be applied, and a trust agreement was entered into in accordance with the terms of the charter. The bonds of the corporation were sold under a prospectus pointing out a source of inquiry as to the charter and trust. The prospectus, however, misstated the purpose for which the proceeds of the bonds were to be used. A federal court held that the trustees were not liable to the bondholders for having used the proceeds in accordance with the trust agreement, and not in the manner set out in the prospectus. It was further held that the company, having sold its bonds by an agent who issued a prospectus stating to what uses the money was to be applied, did not establish a fiduciary relation between the bondholder and the company, and the bondholder could not pursue the money received for the bonds as a trust fund where the company had parted with it to another for a different use, the latter having obtained title as between himself and the company.[3] It appeared in a case that a firm engaged in negotiating bonds for the company negotiated a large number of them, of which fact it did not notify the company. Afterwards, the firm purchased them back and loaned the

[1] Foster *v.* Mansfield, C. & L. M. Ry. Co., 36 Fed. Rep. 627.

[2] Ives *v.* Smith, 3 N. Y. Supp. 645.

[3] Bischoffsheim *v.* Brown, 34 Fed. Rep. 156; Banque Franco-Egyptienne *v.* Brown, 34 Fed. Rep. 162.

company's trustees a sum less than it had received from the sale of the bonds to be used for a certain purpose, pretending to hold the bonds as a collateral for the loan. The court held that this firm could not, on the trustees' applying the money to the uses of their trust, though different from those agreed upon with the firm, follow the property into the hands of those to whom it had been paid, without paying the trustees the money which had been received from the sale of the bonds, the trustees having an equitable title to such money.[1] It was provided in a mortgage executed by a railroad company that certain bonds secured by it remaining in the hands of the trustee should not be issued unless with the assent of a majority in amount of the outstanding preferred stock, and that if any part of such bonds should be used for the construction of branches or extensions, the same should only be countersigned and delivered by the trustee at a rate not exceeding $20,000 per mile of new construction, and upon the certificate of the engineer of the mortgagor that sections of not less than ten miles had been completed, ready for operation. This provision of the mortgage was held in a federal court not to authorize the trustee to refuse to issue them except for continuous sections of ten miles each; that the company was entitled to have the bonds issued for every ten miles of new construction completed and ready for operation, whether in branches, each shorter than ten miles, or in the excess over ten-mile sections.[2] Mortgage bondholders of a corporation, who subscribed to the debenture bonds of the corporation, agreed to pay specified portions of their subscription as called for, they to receive therefor the debenture bonds bearing interest, etc. This undertaking on the part of the bondholders was held by the Supreme Court of Judicature of Massachusetts to be in effect an agreement to loan the corporation money, and not analagous to an unpaid subscription to capital stock; and, therefore, on that theory the creditors of the corporation could not maintain a bill to have the subscriptions to the debenture bonds applied to their claims. It was further held that the fact that the debenture bonds were issued to enable the corporation to complete its railroad did not create any trust in favor of creditors whose claims were for supplies furnished in the

[1] Ibid.

[2] Denver & Rio Grande R. Co. *v.* United States Trust Co., 41 Fed. Rep. 720, an action to compel the trustee to countersign and issue the bonds.

construction of the road; that this contract between the corporation and its bondholders who subscribed for these debenture bonds being executory on both sides, and not assignable by either party, was not within Public Statutes of Massachusetts, chapter 151, section 2, clause 11, giving creditors a remedy in equity to reach and apply "any property, right, title or interest, legal or equitable," belonging to a debtor.[1] Bonds secured by mortgage having been issued by an organization assuming to act as a corporation, and put in circulation, the holders of the stock of such corporation cannot defeat the bonds and mortgages by alleging that the corporation was not duly incorporated.[2] The fact that the road was constructed for less than the amount of the bonds a railroad company may have issued to pay for its construction, will not invalidate such bonds where the contract for construction has been fairly made and carried out and called for that amount.[3] The bonds in this case were issued under the mortgage securing them by a railroad company which had leased its railroad for a

[1] Pettibone *v.* Toledo, C. & St. Louis R. Co., 148 Mass. 411; s. c., 19 N. E. Rep. 337. As to overissue of bonds, see Stephens *v.* Benton, 1 Duv. (Ky.) 112. As to what form of contract would pass title to railroad bonds under particular circumstances, see American Loan & Trust Co. *v.* Toledo, C. & S. Ry. Co., (1890) 47 Fed. Rep. 343. Under what conditions the fact that bonds were issued by a corporation when insolvent does not render them void, see Cochran *v.* Anglo-American Dry Dock & Warehouse Co., 69 Hun, 168; s. c., 23 N. Y. Supp. 404. Bonds of a manufacturing corporation delivered to a bank to secure indebtedness held valid, though the trust company to which the mortgage to secure the bonds was to be given, had not signed them before the delivery to the bank, notwithstanding the bonds provided they would not be valid until signed by the trust company in Gunther *v.* Mayer, 138 N. Y. 654; s. c., 34 N. E. Rep. 513. When a stockholder of a corporation is estopped to contest the validity of its bonds, see Zabriskie *v.* Cleveland, Columbus & Cincinnati R. R. Co., 23 How. 381. When bonds of a corporation hypothecated as a collateral will be held void, see Pfister *v.* Milwaukee Electric Ry. Co., 83 Wis. 86; s. c., 53 N. W. Rep. 27.

[2] Phinizy *v.* Augusta & K. R. Co., 62 Fed. Rep. 678.

[3] Farmers' Loan & Trust Co. *v.* Rockaway Valley R. Co., 69 Fed. Rep. 9. As to when bonds issued by a railroad corporation in excess of the amount of cash paid on its capital stock, or to pay for constructing a road other than the one specified in its articles of incorporation, to be used as a branch line, and secured by a mortgage containing on its face what amounts to a promise by the corporation to observe the law governing the making of such bonds and mortgages, will be held valid in the hands of innocent purchasers, and void in the hands of others, see Baker *v.* Guarantee Trust & Safe Deposit Co., (N. J. Eq.) 31 Atl. Rep. 174.

term of fifty years to a railroad company owning a majority of the shares of its capital stock, the lease providing that the lessee should furnish the necessary rolling stock and equipment for the operation of the railroad, and should receive out of the revenues of the road a reasonable compensation for the use of such rolling stock and equipment. The bonds were five per cent bonds and to mature in forty years. They were taken by the lessee company at ninety per cent of their face value in consideration of a large debt due the lessee company, rolling stock sold to the mortgagor company, and stocks and bonds of other corporations owning roads connecting with and forming feeders of the railroad of the latter company sold to it by the lessee company. Minority stockholders filed a bill praying that these bonds and the mortgage securing them should be declared null and void and decreed to be delivered up for cancellation. The main allegation of the bill was that the transaction consummated by the issuing of the bonds and mortgage in question was a fraudulent scheme concocted for the benefit of the corporation holding the majority of the stock to enable it to raise money for its own purposes, and carried out to the prejudice of the other stockholders of the company, by means of the domination and control which the former company had over the management of the affairs of the latter. The Supreme Court held that these minority stockholders could not complain of an issue of mortgage bonds to a holder of the majority of the stock when such issue was made by the corporation without fraud, for an adequate consideration and with great benefit to the corporation, though the issuance was procured by the majority stockholder for use to raise money for itself and was actually so used.[16]

§ 491. Meeting of stockholders to authorize the issuance of bonds — when legally held.—In this foreclosure suit it was objected to the validity of the bonds that the meeting called to increase the bonded indebtedness of the railroad company was not held within the state as required by the statute of Alabama, which provides that a stockholders' meeting for such a purpose must be held in the state, that the call must state the time, place and object of the meeting, and that a report of the meeting must be filed with the secretary of state. It appeared that notice was

[16] Gloninger *v.* Pittsburgh & Connellsville R. R. Co., (1890) 139 Pa. St. 13; s. c., 21 Atl. Rep. 211; 27 W. N. C. 497.

given to the stockholders of the railroad company of a meeting to be held at a place in the state of Alabama on April 20, 1887, to increase the bonded indebtedness of the company, and prior to that date every stockholder consented in writing to the increase. On March 24, 1887, the board of directors held a meeting in the state, at which the call of the stockholders' meeting and the written consent of all the stockholders were recited, and the issuance of the bonds were authorized; and subsequently a report of the directors' meeting, reciting the stockholders' consent, was filed with the secretary of state. The court held that there was a sufficient compliance with the law of Alabama as to such meetings, and the issue of the bonds was legally authorized.[1]

§ 492. Interest on bonds — what rate, etc.—The railroad bonds upon which this bondholders' suit was based, were issued by a South Carolina railroad company, and the interest was made payable in London. One of the questions before the United States Supreme Court was what rate of interest the principal of these bonds bore. It was held by the court that the contract being made in one place and the performance of the contract to be in another, both as to the interest and the principal, and the interest before maturity being payable according to the legal rate in the place of performance, the presumption was, in the absence of attendant circumstances to show the contrary, that the principal of these bonds bore interest after maturity at the same rate — the rate fixed by the laws of England and not the rate fixed by the laws of South Carolina.[2] There was a covenant in coupon

[1] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531; Grant *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531. In Hodder *v.* Kentucky & Great Eastern Ry. Co., 7 Fed. Rep. 793, it was held that the mortgage of the property of the Kentucky corporation to secure the bonds could be legally acknowledged by its president in the state of Ohio. Bonds and mortgages of corporations organized under Illinois laws have been held not to be invalid merely because executed out of the state. Hervey *v.* Ill. Mid. Ry. Co., 28 Fed. Rep. 169.

[2] Coghlan *v.* South Carolina R. Co., (1891) 142 U. S. 101; s. c., 12 Sup. Ct. Rep. 150. Mr. Justice HARLAN, for the court, after a reference to the authorities upon the subject of such contracts generally, as to this particular one said: "What law, then, did the parties have in view as determining the legal consequences resulting from the non-performance of the contract between them? Presumptively, the law of England, where the contract was to be entirely performed. The bonds and coupons were to be presented and paid there and not elsewhere. They were to be paid in pounds sterling at a designated house in London. The fair inference is that the railroad company negotiated the bonds abroad and made them payable in that city in order to facilitate a sale of them to foreign buyers. Every circumstance connected with the contract tends to show that the parties intended that all questions in respect to performance or the legal consequences of a failure to perform were to be determined by the law of the place, and the only place, where the obligation to make payment could be discharged, and where the breach of that obligation would occur if payment was not made at the appointed time and place. In this view of the contract the rate of interest, after the maturity of the obligations, was not determinable by the law of South Carolina. This is abundantly established by the authorities." See Scudder *v.* Union National Bank, 91 U. S. 406, 412; Scotland County *v.* Hill, 132 U. S. 107, 116; Hall *v.* Cordell, (1891) 142 U. S. 116 (upon a bill of exchange drawn in Missouri payable in Illinois). As to interest and the sale of bonds below par, see Craven *v.* Atlantic & North Carolina R. R. Co., 77 N. C. 289; McGregor *v.* Covington & Lexington R. R. Co., 1 Disney, 509; Morrison *v.* Eaton & H. R. R. Co., 14 Ind. 110; Traders' National Bank *v.* Manufacturing Co., 96 N. C. 298; Coe *v.* Columbus, Piqua & Indiana R. R. Co., 10 Ohio St. 372; Junction R. R. Co. *v.* Bank of Ashland, 12 Wall. 226.

bonds, issued by a railroad corporation, that a sinking fund, sufficient to pay a certain amount of the bonds and accrued interest, should be provided on November fifteenth in each year until the whole amount of the bonds should be paid; that the numbers of the bonds to be paid in each year should be determined by drawing lots, and that the principal of the bonds so drawn should "be payable at the option of the holders, * * * upon the surrender of the bonds drawn, with all the coupons thereto belonging, and after the said 15th day of November the interest upon the bonds should cease." A court of New York has held the option of the holders of the bonds so drawn under this covenant applied only to their right to retain possession of the bonds, and that interest on such bonds ceased on the November fifteenth for which they were drawn, whether surrendered by the holders or not.[1]

§ 493. When principal becomes due.— The mortgage bonds in this foreclosure suit contained the provision that "it is hereby expressly agreed by said company, with each and every holder of this bond, that, in case of the non-payment of any interest coupon hereto attached, if such default shall continue for six months after maturity and demand of payment, the principal of this bond shall become immediately due." The United States Circuit Court of Appeals for the fifth circuit held that the six months was not in addition to days of grace, but was to run

[1] Henry *v.* Syracuse, G. & C. R. Co., 5 N. Y. Supp. 437.

from the date on which the coupons were expressed to be due, and the default having continued in the case two days more than the six months, the bondholders were entitled to declare the principal immediately due. Further, the recitation in the bond as quoted above restricted the provision for the maturity of the bonds for non-payment of interest to the particular bond or bonds on which interest was not paid. Also, an acceptance of interest after the default had continued longer than six months was a waiver of the right to declare the bonds matured. It appearing in the foreclosure suit that the interest was paid on some of the bonds, it became necessary to take an account of the bonds which were properly declared to have matured; and the Court of Appeals held the decree adjudging the bonds to be due to be erroneous and reversed it on that ground.[1]

§ 494. Bonds — when "issued" under Wisconsin statutes. — In a bill in a Court of Chancery brought by a judgment creditor, his execution having been returned *nulla bona*, for the appointment of a receiver and an injunction against a water company and certain purchasers at foreclosure of its property and franchises who had received from this water company bonds to the amount of $100,000 as collateral for $40,000, money advanced, and had afterwards contracted to advance $27,000 more, a part of which had been advanced, the question of the validity of these bonds was before the United States Circuit Court for the eastern district of Wisconsin. The water company had issued bonds to the amount of $125,000, depositing the $25,000 with a trust company under deed of trust. It was held by the court that the bonds, although pledged as collateral and not sold, were "issued" within the meaning of the Revised Statutes of Wisconsin, section 1753, which declares void any bonds issued by a corporation, except for money actually received, equal to seventy-five per cent of their par value; and that these bonds were not enforceable in the hands of the pledgee.[2]

§ 495. When a mortgage trustee should countersign bonds. — The trustee of a railroad mortgage, a trust company, was sued to compel it to countersign and deliver certain mortgage bonds

[1] Alabama & Georgia Mfg. Co. *v.* Robinson, (1893) 56 Fed. Rep. 690; citing Railroad Co. *v.* Fosdick, 106 U. S. 47; s. c., 1 Sup. Ct. Rep. 10.

[2] National Foundry & Pipe Works *v.* Oconto Water Co., (1892) 52 Fed. Rep. 29, in which a receiver was appointed, an injunction granted and the bonds, by order of the court, were to be delivered into the hands of its officers until further order of the court.

to the complainant in the suit. The trustee had refused, relying for justification of its refusal upon a provision in the mortgage that certain bonds secured by it remaining in the hands of the trustee should not be issued unless with the assent of a majority in amount of the outstanding preferred stock; and that, in the event any part of such bonds should be used for the purpose of constructing branches or extensions, the same should only be countersigned and delivered by the trustee at a rate not exceeding $20,000 per mile of new construction, and upon the certificate of the engineer of the mortgagor that sections of not less than ten miles had been completed ready for operation. WALLACE, J., of the United States Circuit Court for the southern district of New York, held that the mortgage did not authorize the trustee to refuse to issue them except for continuous sections of ten miles each, but that the company was entitled to the bonds for every ten miles of new construction completed and ready for operation, whether in branches each shorter than ten miles or in excess over ten-mile sections.[1]

§ 496. Pledge of bonds by a corporation — rights of pledgee, etc. — The statute of Michigan as to railroads provides that "all companies organized under this act shall have power, from time to time, to borrow such sums of money as may be necessary for completing, finishing, or operating their road, or any part thereof, or for paying any indebtedness necessarily incurred for completing, finishing, or operating their road, or any part thereof, and to issue and dispose of their bonds or obligations for any amount necessarily borrowed for such purpose, and for such sums and for such rate of interest, not exceeding ten per cent, as they may deem advisable, and to mortgage their corporate property and franchises, and income thereof, or any part thereof, to secure the payment of any debt contracted, * * * and said company may sell their bonds or obligations either within or with-

[1] Denver & Rio Grande R. Co. *v.* United States Trust Co., (1890) 41 Fed. Rep. 720. The court said: "The object of the clause manifestly is to protect the bondholders against the creation of mortgage indebtedness for new construction not secured by actually completed new lines and against the contingency that bonds might be issued ostensibly to pay for new construction and be used for some object from which the bondholders would derive no benefit. It is framed so as to enable the trustee to know that the bonds to be issued represent completed lines ready for operation and not merely projected new construction."

out the state, and at such place and prices as they may deem proper." There was in this case a resolution in stockholders' meeting of a company in that state directing its managing body "to borrow such sums of money as they may think necessary for completing, equipping and operating its road, * * * and to issue and dispose of the bonds of the company for any amount borrowed for such purpose, for such sums and for such rates of interest, not exceeding seven per cent, as they may deem advisable, and to mortgage the corporate property and franchises, and the income thereof, to secure the same, and to sell such bonds on the best terms they may be able to obtain for the same." They borrowed money from a national bank and pledged some of their bonds issued under this resolution for the payment of the sums borrowed. The United States Circuit Court of Appeals for the sixth circuit held that, under the Michigan statute and the resolution of the stockholders, the corporation was empowered and authorized to pledge its bonds for the money borrowed.[1] It appearing upon foreclosure proceedings that the bonds of a street car company, issued pursuant to a vote of the stockholders "for the purpose of extending and constructing" the road, purchasing rolling stock and equipment, and paying "for labor done and to be done in the construction" and operation of the road, were never sold to procure funds for these purposes, but that, after ineffectual attempts to sell them, were pledged by the president and vice-president of the mortgagor to secure antecedent indebt-

[1] Farmers' Loan & Trust Co. *v.* Toledo & S. H. R. Co., (1893) 54 Fed. Rep. 759. JACKSON, Circuit Judge, said: "Under the New York statute, from which [the Michigan statute] is evidently taken, it is settled that under authority to borrow money and 'to issue and dispose of bonds' in connection therewith, there is a right to pledge such securities as collateral for the sums borrowed. Duncomb *v.* Railroad Co., 84 N. Y. 190. So in Beecher *v.* Mill Co., 45 Mich. 103; s. c., 7 N. W. Rep. 695, where bonds of a corporation were issued on the understanding that they were to be sold for cash, but were in fact pledged to a creditor as collateral to corporate notes held by him, it seems to have been held by the court that the objection that such disposition of the bonds was unlawful could only be taken by the corporation or its stockholders; that it was not open to strangers or even to a purchaser of the equity of redemption at execution. Without going into a review of the decisions, we are of opinion that the weight of modern authority, as well as sound principle, establishes the general rule that, in respect to negotiable securities, authority to sell carries with it authority to pledge. Platt *v.* Railroad Co., 99 U. S. 48; and Leo *v.* Railroad Co., 17 Fed. Rep. 275."

edness of the company, which to a large extent was due to other companies of which also they were officers and directors, it was held by the United States Circuit Court for the southern district of California that the pledge was without authority, and in fraud of the rights of the stockholders.[1] The lower court in the foreclosure suit decreed in favor of a bank which had loaned the railroad corporation a large sum of money on bonds of the corporation pledged to it as collateral, the amount loaned with interest, which was not as much as the face of the bonds represented. The United States Court of Appeals for the sixth circuit held that this was erroneous, and that the holder of these bonds was entitled to have a decree for the whole amount due upon them.[2] A railroad company, incorporated

[1] Farmers' Loan & Trust Co. *v.* San Diego St. Car Co., (1891) 45 Fed. Rep. 518, in which case, as in the opinion of the court none of the bonds in question ever were legally issued, or ever became valid outstanding obligations of the defendant corporation, the bill for foreclosure of mortgage was held not to be well pled. It was said by the court: "Aside from the want of legal power already referred to, a court of equity will not permit the directors of a corporation, who are not only trustees for the stockholders of the corporation, but for its creditors as well, to thus dispose of the corporate property to themselves, or for their individual benefit. However in fact intended, equity treats such transfer as fraudulent, because it operates as a fraud upon the *cestui que trustent*. Koehler *v.* Black River, etc., Co., 2 Black, 717." See, also, upon the general subject, Richardson's Exrs. *v.* Green, 133 U. S. 30; s. c., 10 Sup. Ct. Rep. 280. In California, it is provided by statute that "neither a trustee, nor any of his agents, may take part in any transaction concerning the trust in which he, or any one for whom he acts as agent, has an interest, present or contingent, adverse to that of his beneficiary," with certain enumerated exceptions not applicable to the present case. Civil Code Cal. § 2230. And section 2234 of the same Code declares that every violation of the provisions, among others, of section 2230, "is a fraud against the beneficiaries of the trust." These Code provisions have been held applicable to the directors of corporations in their trust relations by the Supreme Court of the State. Graves *v.* Mining Co., 81 Cal. 303; s. c., 22 Pac. Rep. 665.

[2] Farmers' Loan & Trust Co. *v.* Toledo & S. H. R. Co., (1893) 54 Fed. Rep. 759. JACKSON, Circuit Judge, said: "The sale and purchase of these bonds by the bank under and within the terms of the railroad company's note and pledge of the collateral were not *per se* void. It was at most only voidable, at the instance and upon reasonable objection on the part of the corporation or its stockholders. Third parties or strangers have no right to question or challenge the bank's title to the bonds on the ground either of inadequacy of the price paid for the same, or for the reason that it occupied such a *quasi* trust relation to the pledgee as to disqualify it from purchasing at a sale made for its own benefit. The securities having been regularly issued and hypothecated as

under the laws of Virginia, executed a first mortgage upon its road, to secure bonds to the amount of $15,000 per mile. The greater portion of these bonds passed into the hands of purchasers. Afterwards, desiring to build an extension of its road, the stockholders authorized a second mortgage to the same trustees as in the first mortgage, to secure bonds to the amount of $25,000 per mile of its road. The resolutions as to this second mortgage, and all the proceedings preliminary to the execution of this second mortgage, showed the intention to be to take up the bonds issued under the first mortgage by an exchange of second mortgage bonds, or raising of money on the latter and paying off the former. The railroad company, foreseeing that it might not be able to exchange the general mortgage bonds for the first mortgage bonds, made this provision, that "until all bonds which have been and may hereafter be issued under the security of the first mortgage * * * shall come into the hands of the trustee of this mortgage under this provision," [the provision for exchange] "and the trustees of this mortgage shall determine the advisability of the satisfaction and release of the said first mortgage * * * all such first mortgage bonds which shall come into the hands of the trustees, under this provision, shall be held by the trustees uncanceled for the security and benefit of the holders of the bonds secured thereby; * * * " Fifteen days after the general mortgage was executed, bonds, to the amount authorized under the first mortgage, not already issued, were, in pursuance of the prescribed terms, duly issued by the railroad company and delivered by its treasurer to the trust company as trustee on the first mortgage. These bonds under the general mortgage were sold principally to a syndicate under the terms of a prospectus which virtually pledged these bonds issued under the first mortgage as a collateral for the security of the bondholders under the general mortgage. The general mortgage was afterwards fore-

collateral for a debt the company was authorized to contract, and thereafter lawfully sold under the terms of the pledge, upon proper notice, even the maker of the paper could not impeach the purchaser's title thereto, and the right to recover the amount thereof, without setting up and establishing fraud or breach of trust causing injury. Such an objection by way of impeachment of the purchaser's title to the pledged security is confined to the corporation or its stockholders. [This intervener's] relation to the railroad company was not such as entitled him to question the bank's title to the bonds, or complainant's right, as the legal representative of the bondholders, to foreclose for the full amount thereof."

closed. In the final decree the court below held that the bondholders under the general mortgage were entitled to share in the security of the first mortgage to the extent of $1,560,000, the amount of the first mortgage bonds deposited with the trustee as collateral security for the payment of the general mortgage bonds. The majority of the Supreme Court of Virginia affirmed the decree of the lower court, holding that in placing these bonds as security for the general mortgage bonds the company violated no rights of the first mortgage bondholders; that as to these bonds both sets of bondholders stood upon the same footing; that there was no overissue; that the failure of the trustees to certify these particular bonds, as directed, did not affect their validity.[1]

§ 497. Validity of bonds — as affected by statutory or constitutional provisions.— The Code of Alabama requires subscriptions to railroad stocks, which are payable in labor or property, to be taken at their money value, which must be stated in the subscription list. In this case it appeared that a railroad company adopted a resolution to sell all its property to another company for $750,000, one-half in stock and one-half in bonds of the purchaser, and subsequently entered a subscription for $375,000 of stock "to be paid for in the railroad property" of the seller, "of the value of the said sum of three hundred and seventy-five thousand dollars." The United States Circuit Court of Appeals for the fifth circuit held that, reading the subscription in connection with the resolution, as it must be, its language was not conclusive that the value of the entire property was not over $375,000, so as to render void the issue of $375,000 in bonds under the constitutional provision forbidding overcapitalization. They declared this further rule, that, under the constitutional provision of that state forbidding corporations to issue stock or bonds except for money, labor or property actually received, and the before-mentioned Code provision as to subscriptions payable in money, labor or property, railroad property sold by one company to another and paid for by an issue of stock, as in this case, may be valued according to its net earning power, and the cost of building it *de novo*, and that it was immaterial that the seller originally acquired it for much less than its actual value.[2] In

[1] Atwood *v.* Shenandoah Valley R. R. Co., (1889) 85 Va. 966.

[2] Grant *v.* East & West R. Co. of Alabama, (1893) 54 Fed. Rep. 569.

this case it appeared that certain stockholders and directors of a railroad company, owning a controlling interest in the company, having the best interests of the company in view, and with the concurrence of all the other stockholders, made a contract on behalf of the company with a construction company for the building of a portion of the road to be paid for in bonds to the extent of $10,000 per mile, and the same amount in stock of the railroad company. The United States Circuit Court for the northern district of Alabama held that as the contract appeared to be fair, under the circumstances, and involved no fraudulent overvaluation of the work, the bonds and stock issued in terms of the contract were not void under the provision of the Constitution of Alabama that "no corporation shall issue stock except for money, labor done, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void."[1] A

There was a contention in this case that the taking of the property at double the price which was considered its real value, payable in equal amounts of stock and bonds of said company, was illegal under the Alabama laws, and by absorbing into said bonds the full real value of the property secured on the subscription, worked a fraud on the rights of subsequent creditors, for whose protection that stock of the company and its proceeds constituted a trust fund independent of any state, organic, or statute law. The court held adversely to this contention. McCormick, Circuit Judge, speaking for the court, said: "It has long been the settled doctrine of the United States courts that the capital stock of an insolvent corporation is a trust fund for the payment of its debts; that the law implies a promise by the original subscribers of stock who do not pay for it in money or other property to pay for the same when called upon by the creditors; and that a contract between themselves and the corporation that the stock shall be treated as fully paid and non-assessable, or otherwise limiting their liability therefor, is void as against creditors. Sawyer *v.* Hoag, 17 Wall. 610; Upton *v.* Tribilcock, 91 U. S. 45; Sanger *v.* Upton, 91 U. S. 56; Webster *v.* Upton, 91 U. S. 65; Chubb *v.* Upton, 95 U. S. 665; Pullman *v.* Upton, 96 U. S. 328; Graham *v.* Railroad Co., 102 U. S. 148–161; Hawkins *v.* Glenn, 131 U. S. 319; s. c., 9 Sup. Ct. Rep. 739. And the trust arising in favor of creditors by subscriptions to the stock of a corporation cannot be defeated by a stipulated payment of subscription, nor by any device short of an actual payment in good faith. Camden *v.* Stuart, 144 U. S. 104; s. c., 12 Sup. Ct. Rep. 585. The well-settled doctrine of the general law relating to subscriptions to the stock of corporations, as announced by the United States Supreme Court in the cases above cited, has been embodied in the Constitutions and Codes of many of the states; and issues of stocks and bonds, under constitutional and statutory provisions substantially similar to those in Alabama, have been sustained when they have been disposed of by a corporation after its organization for the best price that could be obtained, though for less than their face value. Railroad Co. *v.* Thompson, 103 Ill. 187; Railroad Co. *v.* Dow, 120 U. S. 287; s. c., 7 Sup. Ct. Rep. 482; Handley *v.* Stutz, 139 U. S. 417; s. c., 11 Sup. Ct. Rep. 530; Clark *v.* Bever, 139 U. S. 96; s. c., 11 Sup. Ct. Rep. 468; Fogg *v.* Blair, 139 U. S. 118; s. c., 11 Sup. Ct. Rep. 476. When the charter of a corporation or the general law under which it is created authorizes the capital stock to be paid for in property, and the shareholders honestly and in good faith pay for their subscriptions in property instead of money, there is an end of trust in favor of anybody, and third parties, even subsequent creditors, have no ground of complaint, although a gross and obvious overvaluation of such property would be strong evidence of fraud in an action by a creditor to enforce personal liability. Coit *v.* Gold Amalgamating Co., 119 U. S. 343; s. c., 7 Sup. Ct. Rep. 231."

[1] Coe *v.* East & West. R. Co. of Ala., (1892), 52 Fed. Rep. 531. Pardee, Circuit Judge, said: "A provision in the Constitution of Arkansas, almost identical with that of the state of Alabama, has been construed by the Supreme Court of the United States not to prevent the carrying out of an agreement by which the bondholders of a railroad stipulated that the road should be bought upon foreclosure by trustees, who should convey it to a new company composed of bondholders, who should receive mortgage bonds of the new company in exchange for their old bonds, and full paid-up stock subject to the mortgage debt, without any payment of money. The court said: 'But appellant disputes its liability upon the bonds given for the balance upon the theory that they were prohibited from issuing them by the * * * Constitution of Arkansas. * * * That section provides that 'no private corporation shall issue stock or bonds except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void.' In support of this view our attention is called to the fact admitted by the demurrer, that the full value of the property rights and privileges conveyed to appellant did not exceed $1,300,000, the amount at which the capital stock was fixed; and consequently, it is argued, the $2,600,000 of bonds were issued without any consideration received in money, property or labor, and represented only a fictitious indebtedness. In other words, appellant's vendors were fully compensated for their interests by taking to themselves its entire stock. We do not concur in this view of the case. It does not, we think, rest upon a sound interpretation of the State Constitution. The prohibition against the issuing of stock or bonds, except for money or property, actually received, or labor done, and against the fictitious increase of stock or indebtedness, was intended to protect stockholders against spoliation, and to guard the public against securities that were absolutely worthless. One of the mischiefs sought to be remedied is the flooding of the market with stock and bonds that do not represent anything whatever of substantial value. In reference to a provision in the Constitution of Illinois, adopted in 1870, containing a prohibition as to railroad corporations similar to that imposed by the Arkansas Constitution upon all private corporations, the Supreme Court of the former state in Railroad Co. *v.* Thompson, 103 Ill. 187–201, said: 'The latter part of the clause of the Constitution in question which declares that 'all stocks, dividends and other fictitious increase of the capital stock or indebtedness of such corporation shall be void,' we think clearly points out the chief object

Minnesota railroad company entered into a contract with parties to construct a portion of its road. By the terms of that contract a certain amount of the company's first mortgage bonds, guaranteed by another corporation, a mining company located on the company's railroad, and a certain amount of shares of its stock, were to be placed in the hands of a trustee, to be delivered to the contractor when the road was completed. The right of the company to issue these bonds and the stock and use it in this way was questioned in an action by one claiming to be a stockholder of the company to restrain the company from this act, as an *ultra vires* act on its part, it being claimed that it was in violation of the Minnesota statute, prohibiting any railroad company or officer thereof from selling or disposing of shares of its capital stock, or issuing certificates therefor, unless such shares shall have been fully paid, or issuing any stock or bonds, except for money, labor or property received and applied for the purpose for which the corporation was created. It was held by the court that this statute did not forbid the issue of first mortgage bonds and full-paid stock by the company in payment for the construction of the road, if the amount did not unreasonably exceed the value actually received.[1] The statute of New York, providing that no

which the constitutional convention sought to accomplish in adopting it, and to this we must look in a large degree for a solution of the language which precedes it. The object was doubtless to prevent reckless and unscrupulous speculators, under the guise of pretense of building a railroad, or of accomplishing some other legitimate corporate purpose, from fraudulently issuing and putting upon the market bonds or stock that do not, and are not intended to, represent money or property of any kind, either in possession or expectancy, the stock or bonds in such case being entirely fictitious.'" Railroad Co. *v.* Dow, 120 U. S. 287–297; s. c., 7 Sup. Ct. Rep. 482.

[1] Brown *v.* Duluth, M. & N. Ry. Co., (1893) 53 Fed. Rep. 889. NELSON, D. J., said: "This statute was not intended to prevent or interfere with the usual method of raising money to build railroads, or for any legitimate corporate purpose. It is not to be construed as obstructive to the extent of restricting and hampering corporations in their internal management, and embarrass them in procuring means to carry out the legitimate purposes of the corporation; and, unless it appears that under the guise of building its road, bonds and stock of the defendant company are to be issued and put upon the market fraudulently that do not and are not intended to represent money and property, this corporation is not prohibited from entering into a real transaction based upon a present consideration, and having reference to legitimate corporate purposes. Beach on Corp. 909, and authorities there cited. Such a transaction is not a scheme or device to evade the statute. It may be that an amount of corporate bonds and stock turned over by a corporation is so much in excess of the expenditures

corporation shall issue bonds, "except for money, labor done, or property actually received for the use and lawful purposes of such corporation," has been held to prohibit an issue of bonds by the corporation to pay scrip dividends.[1]

§ 498. Validity of bonds as affected by the manner of sale and character of purchasers.— The validity of the bonds of this railroad company received by certain of its stockholders and directors by purchase from a construction company, to which they were issued by the railroad company in payment for the construction of its road upon a contract of so much in bonds and so much in stock per mile, was sustained in a foreclosure suit by the holders of consolidated first mortgage bonds, purchased by them from those to whom they were issued and those bonds for construction taken up by the company. The complainants sought to invalidate the bonds held outside of themselves as being based upon an improper contract for the construction of the road.[2]

to be made by the recipients of the same that a court would hold that the statute prohibited such a transaction; but if the purpose of the corporation in issuing bonds and stock is to build its road and no unreasonable amount is issued beyond the value actually received or provided for, the statute in my opinion does not apply." Citing Railroad Co. *v.* Dow, 120 U. S. 298; s. c., 7 Sup. Ct. Rep. 482.

[1] Merz *v.* Interior Conduit & Insulation Co., (1895) 34 N. Y. Supp. 215. Bonds of a corporation held not a fictitious indebtedness prohibited by the Constitution of Texas, in North Side Ry. Co. *v.* Worthington, (Tex. Civ. App.) 27 S. W. Rep. 746.

[2] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531. It was said by the court: "Certainly, if the contract inured to the benefit of the railroad company, and was the best available method for securing the construction of the road, and there was no palpable overvaluation of the work performed and moneys advanced, nor undervaluation of the stocks and bonds received in payment, and it resulted in no injury to any person in interest at the time, it should not be set aside on technicalities, but only in case of palpable intended violation of law. The case of Van Cott *v.* Van Brunt, 82 N. Y. 535, is directly in point: 'The right of the officers of a railroad corporation to enter into an agreement to build its road and pay for the construction of the same in stocks and bonds cannot be seriously questioned, and contracts of this description are frequently made for such a purpose.' In Angell & Ames on Corporations (§ 590a) it is laid down: 'An agreement is often made by railroads to pay the persons building them a certain proportion of the contract price in stock. Under such a contract the contractor is entitled to the proportion in stock at its current market value at the time payment should have been made. And if the stock depreciate so that it has no market value, the amount agreed to be paid in stock must be paid in money.' See Hart *v.* Lauman, 29 Barb. 410; Moore *v.* Rail-

These same stockholders and directors, retaining control of the railroad company, failed to collect interest on the first bonds of the company held by them, and advanced to the company money for repairs made necessary by an unusual flood, and for improvements until the floating debt due them amounted to more than $300,000. A meeting of stockholders authorized the issue of debenture bonds of the railroad company, not exceeding $500,000,

road Co., 12 Barb. 156; Porter *v.* Railroad Co., 32 Me. 539. If a contract can be made to pay in part for building a portion of the road, it may also be made to pay for the whole thereof in like manner, and there is no valid ground for claiming that, where the contractor is entitled to stock at its market value, he would be liable for the difference between the market value and the par value thereof. There is no evidence in the record before us to establish affirmatively that the value of the work done and materials furnished was less than the fair and just value of the stock, or that the road built or equipped was worth less than said stock. In fact the testimony shows that the amount expended exceeded the actual value of the stock and bonds which were received in consideration of the same. The evidence also establishes that the stock never had any market value whatever. It is true that some of the bonds were disposed of at fifty and sixty-five cents upon the dollar and less, and in some instances by throwing in stock to the same amount and one-half more, and in one instance taken at par in part payment of a debt, but they were intrinsically valueless, and after a while were sold for only a nominal sum, until at last no one outside of the company would take either the bonds or stock at any real price. The arrangement for the building of the road was made after full deliberation and consultation, with the knowledge and approval of all the directors and stockholders. It was assented to as the only means furnished, and the only offer which could be obtained from any one to insure the construction of the railroad. It was the best thing that could be done under the circumstances, was entirely satisfactory, and made most clearly without any intention to defraud the company or its creditors and in perfect good faith. It is difficult to see how creditors could be defrauded when all the property which the company ever had remained in its possession and under its control. * * * It is claimed that the defendant, as president, director and trustee, having wrongfully appropriated the stock to himself without paying for it, takes all the obligations of a subscriber. This depends upon the question whether the transfer of the stock to the defendant and the application of the same was wrongful. It was done, as we have seen, with the full approval of the stockholders, and in fact was a necessity, and, without the contract entered into, no portion of the road could have been built. If the defendant had realized a sum beyond the amount actually expended, there might have been perhaps some ground for claiming that the arrangement should inure to and for the benefit of the company. As, however, this was not the fact, and no special advantage accrued to the defendant from the contract, and as there is no proof of any fraud, it is not apparent that there was any wrongful appropriation of the stocks and bonds or that the stocks and bonds were diverted from their legitimate

for the purpose of paying the floating debt, to be secured by a second mortgage. A resolution of the directors had previously determined that these debenture bonds, when issued, should not be disposed of at less than sixty-five per cent of their face value. The court held as to these bonds that the purchase by the holders of the floating debt of the whole amount of bonds authorized, by

use. The mere fact that the defendant held a certificate of the stock which was transferred to him did not make him liable, as it was to all intents and purposes paid-up stock." This case has received some adverse criticism (2 Mor. Priv. Corp. § 826; Cook Stocks & S. § 47, note 5; Jackson *v.* Traer, 64 Iowa, 483; s. c., 20 N. W. Rep. 764), but it has been cited with approval and its doctrines have been reaffirmed by the court of last resort in the state of New York in the case of Barr *v.* Railroad Co., 125 N. Y. 263; s. c., 26 N. E. Rep. 145, where it is said: "The respondent has questioned the legality or validity of the issue of shares upon which plaintiffs base their right to sue. I do not think it is in a position to raise that question, and for several manifest reasons. All of the stock and bonds were issued in payment for the construction of the railroad, and were taken by a syndicate of persons who assumed the contract for the work. It is true that that syndicate was made up of members of the board of directors, but as the members of the syndicate were practically the company, and composed the whole number of stockholders, there was no one to object, and the manner in which they chose to divide up their interests in the proprietorship of the corporation, and to represent them in shares, concerned only themselves. No principle of law forbade the company agreeing to pay for the construction of its railroad in the way or in the amount it did. Van Cott *v.* Van Brunt, 82 N. Y. 535. If the company's directors were interested in the work and profits of construction, and evaded a direct contract through the form or device of an intermediary contractor, that was a matter for the company or for its stockholders to take hold of. But the stockholders and the members of the syndicate were the same persons, and, however wrong the transaction might be if other persons were concerned, here no injury was effected to any one interested in the corporation. And, however illegal the transaction, there was no person apparently to complain of it. As the stock was issued as a part of the consideration for construction, it cannot be said that it was taken without value given, and the mode of its apportionment or division concerned only those interested in the contract through which it was received as payment. We may concede that the contract was voidable as a scheme concocted by the directors for sharing in the profits of construction, but the difficulty is that the members of the corporation were assenting to it. There was, however, no fraud practiced upon the company. Practically, the promoters of the corporation in this way placed a valuation upon the corporate properties and franchises which the contribution and expenditure of their money created, and the fact that they were created for an expenditure less than the par value of the aggregate issues of capital stock and bonds does not affect the question at all."

the terms of which they paid for them in this floating indebtedness and the balance in cash, was valid.[1] Certain bonds of a railroad company had been placed in the hands of a trust company to be by said trust company, upon the completion of work of construction of an extension of the railroad by a construction company, delivered over to the latter, on certain certificates of the completion of the extension. When the extension was practically completed the bonds were issued on certificates to the construction company, but the trust company retained them to secure prior advances to the construction company. In the foreclosure suit upon these bonds, an intervening judgment creditor, who had constructed a part of this extension under a contract with the construction company, but had brought his action against the railroad company upon which his judgment was recovered, after the failure of the construction company, set up a claim to these bonds so retained by the trust company. The court held that he had no claim to those bonds to subject them to the satisfaction of his judgment, but the court recognized his judgment as a valid judgment against the railroad company, but inferior as a lien to that of the bondholders under the first consolidated mortgage which was being foreclosed.[2] A contract for the lease of a railroad belonging to an iron company was entered into by a railroad company represented by certain stockholders and directors, they being also stockholders and directors of the iron company, which contract was in good faith and in the form of a resolution by the directors of the railroad company, the payment for the lease to be in stocks and bonds of the railroad company and of a subscription by the iron company to be paid in property — a lease of its railroad, and the contract was ratified by a unanimous vote of all the stockholders of the railroad company. The validity of the bonds issued to the iron company in terms of this contract was questioned in this foreclosure suit. It was held by the United States Circuit Court that the contract was, at least, only voidable, and as no fraud or intentional overvaluation appeared, and the consideration was as nearly adequate as could be expected

[1] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531. When a purchaser of bonds is put upon inquiry in regard to the regularity or validity of their issue by the low price at which they are offered, see Riggs *v.* Pennsylvania & New England R. R. Co., 16 Fed. Rep. 804.

[2] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531; Grant *v.* East & West R. Co. of Ala. (Schley, Intervener), (1892) 52 Fed. Rep. 531.

under the circumstances, the bonds issued to the iron company were valid.[1]

§ 499. Reorganization — surrender of old bonds and stock for new bonds — rules.—A bondholder in this case it appeared had declined to surrender and exchange his mortgage bonds pursuant to a reorganization agreement which he refused to accept in a suit to collect the mortgage bonds according to the terms of the original mortgage, while all of the bonds except his were surrendered and exchanged. The federal court in the district where this suit was brought had substantially confirmed the reorganization; the trustee of the bondholders was a party defendant to the suit and fairly represented the rights of all. The interest representing ninety-nine per cent of the bondholders demanded the judgment. The rights of the non-conforming bondholders were fully recognized in the decree of the court by providing that the company should execute an indemnity bond conditioned for the payment of the bonds of those dissenting as to the judgment, and that this bondholder might recover under the decree all he was entitled to. There was a cross-bill filed by the companies to compel this bondholder, who brought the suit, to surrender his bonds and receive in lieu thereof new bonds according to the reorganization agreement. The United States Circuit Court for the southern district of New York held that the decree in the original suit properly protected his interests; that he must surrender his old bonds and accept the new ones as provided for in the agreement, but that he was entitled to the same security afforded the majority bondholders. The cross-complainants, the railroad companies, having taken the position throughout the suit that the bondholder suing could at any time surrender his bonds and receive new ones in lieu thereof under the original decree, and their counsel in their brief having offered to deliver the bonds and cash upon such surrender, it was further held that the cross-complainants were not in a position to insist that the bondholder suing had by his misconduct forfeited his rights to interest.[2] The decree entered in a bill to foreclose a mortgage upon the property of a railroad company in this case authorized such bondholders as should become purchasers to pay their bids in bonds.

[1] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531.

[2] Pollitz *v.* Farmers' Loan & Trust Co., (1892) 53 Fed. Rep. 210.

The representative of certain bondholders purchased the property and a master was appointed to report distribution and the form of the conveyances. The master reported that the purchase by the representative above mentioned was on behalf of certain bondholders named, not including the one who brought this action, and of such others as might wish to join in the purchase and pay their proportions of the purchase money and expenses, and that the property was bought to sell again in such manner as three-fourths of the bondholders should direct. The form of deed to the purchaser reported by the master recited that it was in trust for all the bondholders. Afterwards, as directed by three-fourths of the bondholders, the representative of the bondholders conveyed the property to a railroad company, organized by the purchasing bondholders to succeed the former company, "free and discharged from all and every trust whatsoever." The act incorporating this new company recited that the company was composed of persons named and "all others who held mortgage bonds," but the preamble set out the deed to the representative of the bondholders "in trust for all the bondholders who participated in the said purchase," and that it was desirable "to reimburse the said bondholders for their expenditure of money and labor." The plaintiff in this case, as surviving partner of a firm, afterwards discovering among the firm's assets a bond of the old company, which, by its terms, was convertible into stock, brought assumpsit against the corporation formed by the purchasing bondholders to recover for their refusal to exchange stock in the new company for the bond, claiming that the representative of the bondholders took as trustee for all the bondholders of the old company, and that the conveyance to the new company was really with the agreement that the latter company assumed the duties of the representative of the bondholders as such trustee, and that, therefore, the new company was bound to make the exchange which he demanded. The Supreme Court of Pennsylvania held that it was clear, from a consideration of the foreclosure decree, the deeds to and from the representative of the bondholders, the master's report and the act incorporating the new company, that the plaintiff had merely an option to participate in the new venture by coming in within a reasonable time and sharing in the expenses and risk; that the representative's duty, notwithstanding general expressions in the deeds and the

act of incorporation, was to distribute stock to such bondholders as participated in the original purchase or subsequently exercised their option to come in, and the last chance to exercise this option was when the deed was made to the new company clear of all trusts.[1] The United States Supreme Court has given a full consideration to the effect of the constitutional provision of the state of Arkansas that "no private corporation shall issue stock or bonds except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void." They held that the provision did not prevent the carrying out of an agreement between mortgage bondholders of an embarrassed railroad company in that state by which it was agreed that trustees should buy in the mortgaged property on foreclosure and convey it to a new company which should issue new mortgage bonds to pay the expenses of the sale, and other new mortgage bonds to be taken by the bondholders in lieu of their old bonds and full paid-up stock, subject to the mortgage debt, to be delivered to and held by the bondholders without any payment of money; and, further, the bonds issued under such an agreement were not subject to the provisions of the statutes of that state respecting the legal rate of interest for certain classes of railroad securities.[2]

§ 500. Bondholders — when bona fide holders, and when not — the rights of such. — A *bona fide* purchaser, before maturity, of coupon bonds of a railroad company payable to bearer, takes them freed from any equities that might have been set up against the original holder; and the burden of proof is on him who assails the *bona fides* of such purchase.[3] A *bona fide* holder of negotiable bonds of a corporation is not subject to the general doctrine of *lis pendens;* and this applies even if the bonds were purchased during the pendency of a suit in which the issue of the bonds was finally declared invalid.[4] Bonds which

[1] Landis *v.* West Pennsylvania R. R. Co., (1890) 133 Pa. St. 579. This action was brought thirty years after the sale of the property.

[2] Memphis & Little Rock Railroad *v.* Dow, (1887) 120 U. S. 287.

[3] Kneeland *v.* Lawrence, (1891) 140 U. S. 209, in which the holder was not held to be a *bona fide* purchaser. See Murray *v.* Lardner, 2 Wall. 110, 121, and cases there cited.

[4] Farmers' Loan & Trust Co. *v.* Toledo & S. H. R. Co., (1893) 54 Fed. Rep. 759; citing Lexington *v.* Butler, 14 Wall. 283; Warren County *v.* Marcy, 97 U. S. 96; Douglass *v.* Pike County, 101 U. S. 687; 2 Beach Priv. Corp. § 666.

may have been issued to a contractor who had in course of trade passed title to the bonds to a purchaser in good faith, the latter's right to recover on the bonds is not open to any defenses on the part of the corporation which they may have had against the contractor in connection with the performance of his contract.[1] The purchaser of the bonds of the corporation from its president and one of its directors, inquired of the vice-president, secretary and attorney as to their validity, and was informed by each that the bonds were regularly issued and sold, and were valid. The books of the corporation showed that the bonds were authorized to be sold for $35,000; that the name of the director from whom the purchase was made was entered as the purchaser, and that he was credited with that sum of money. The purchaser from the director was held to be an innocent purchaser, and the corporation was held to be estopped to deny the validity of the bonds, as against him. The corporation which, with the knowledge and consent of all its stockholders, had sold certain of its bonds to its directors for less than par, but for their full actual value, was also held estopped from questioning the validity of the sale of bonds, either as against the directors or their assignees.[2] An objection was urged in this case that the sale of the amount disposed of of general mortgage bonds was negotiated by a banking house, who were the financial agents of the railroad company, and the bonds were purchased or subscribed for by this banking firm, or by members thereof, standing in a fiduciary relation to the railroad company, which rendered the whole transaction invalid, and, therefore, rendered this deposit of the 1,560 bonds as collateral also invalid. The Supreme Court of Virginia held that the principles controlling fiduciary relations had no application; that the transaction was merely a lending of money on one side and a borrowing on the other.[3] The holder of the first

[1] McElrath *v.* Pittsburg & Steubenville R. R. Co., 55 Pa. St. 189.

[2] Union Loan & Trust Co. *v.* Southern California Motor Road Co., (1892) 51 Fed. Rep. 840.

[3] Atwood *v.* Shenandoah Valley R. R. Co., (1889) 85 Va. 966. The court said: "In Hotel Co. *v.* Wade, 97 U. S. 13, it was said: But where stockholders sanction a contract under which directors loan money to the corporation, and its bonds, secured by mortgage, are given, if the money is properly applied, the corporation is estopped from setting up that the bonds and mortgage are void by reason of the trust relations which directors sustained to it. Here the railroad company not only obtained the loan on the terms dictated by it, but received the cash and actually expended it in the construction of the extension of its road. Could there be any higher sanction than this? We think not. It would be an almost barbarous rule that would forbid a transaction of this character, and one that would at least hazard the undoing of all common transactions of mankind. Even in the cases where the equitable principle in question is given its widest scope, the general rule is that the contract may be avoided at the election of the stockholders, or *cestui que trust*, upon the terms of restoring what the trustee or agent has parted with in the transaction. The principle underlying this doctrine is forcibly stated by FINCH, J., in Duncomb *v.* N. Y., H. & N. R. R. Co., 84 N. Y. 190, where it is said: 'Nor is it at all questioned that in such cases the right of the beneficiaries, or those claiming through them to avoidance, does not depend upon the question whether the trustee in fact has acted fraudulently or in good faith and honestly, but is founded upon the known weakness of human nature, and the peril of permitting any sort of collision between the personal interests of the individual and his duties as trustee in his fiduciary character. Davoue *v.* Fanning, 2 Johns. Ch. 260. But the rule was adopted to secure justice, not to work injustice; to prevent a wrong, not to substitute one wrong for another, and hence have arisen limitations upon its operation calculated to guard it against evil results as inequitable as those it was designed to prevent. Thus, the beneficiary may avoid the act of the trustee, but cannot do so without restoring what it has received. York Co. *v.* Mackenzie, 8 B. Par. Cas. 42. To cling to the fruits of the trustee's dealing while seeking to avoid his act; to take the benefit of his loan and yet avoid and reverse its security, would be grossly inequitable and unjust. It would turn a rule, designed as a protection, into a weapon of offence and injustice.'"

mortgage bonds of this railroad company contracted with brokers to sell them all their bonds; they transferred to the brokers a portion of the bonds, and together with the brokers fraudulently procured the listing of the bonds on the New York Exchange. The complainants in the auxiliary suit for foreclosure of this mortgage, who had purchased some of these bonds, which had been pledged to them as loans made to the brokers, claimed that they were entitled to priority upon their bonds to those held by the bondholders in the main suit, on account of fraud practiced upon them. The court held that complainants in the auxiliary bill, who loaned money to the brokers on these bonds as security, relying either on the standing and representations of the brokers, or on quotations made in the New York Stock Exchange, and produced by fictitious manipulations of the brokers, and not on the false representations as to the earnings of the company, etc., made by the original holders to secure the listing, and who, on non-payment of the loans, were compelled to buy in the bonds held as security, were not, on the ground of fraud, entitled to priority over the original holders in the application of the pro-

ceeds of the foreclosure to the satisfaction of the bonds.[1] The United States Supreme Court has applied the doctrine that where negotiable paper has been put in circulation, and there is no infirmity or defense between the antecedent parties thereto, a purchaser of such securities is entitled to recover thereon as against the maker the whole amount, irrespective of what he may have paid therefor, in a case involving the following statement of facts: A railroad company contracted with a construction company to build and complete its railroad on a line designated on a map of the same, and to furnish and equip it, agreeing to pay for the same in stock and mortgage bonds to be issued from time to time as sections should be completed. A mortgage was made of the road and property then existing and afterwards to be acquired. The construction company began work and completed a small section, for which it received the stipulated pay in stock and bonds. It parted with the latter for a good consideration, and they eventually came by purchase into the possession of the bondholder, the trustees of whose estate brought the suit for the purpose of enforcing the mortgage lien. No further section was completed, but work was done at various points on the line, and the construction company acquired for the railroad company rights of way through nearly or quite the entire route. Subsequently another railroad company acquired these properties through the construction company, and completed the road. The court held that the bondholder, whose bonds were involved in the suit, being a *bona fide* holder of the bonds secured by the first mortgage, had through the mortgage a prior lien on the whole line for the full amount of the face of his bonds, which was not affected by the fact that the new company acquired its rights and property, not directly from the first company, but through intervening conveyances.[2] The railroad company here, in accordance

[1] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531; Grant *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531.

[2] Wade *v.* Chicago, Springfield & St. Louis R. R. Co., (1893) 149 U. S. 327; s. c., 13 Sup. Ct. Rep. 892. Mr. Justice JACKSON, for the court, said: "The bonds were valid securities in the hands of the trustee for the protection of Wade as accommodation indorser for Wing or the construction company, by whom they were pledged, and the pledgee or purchaser thereunder succeeded to the rights of the pledgor, and upon no principle could such purchaser, as against the maker, be restricted to what he might pay for the bonds. Negotiable securities once put in circulation for value may be transferred for less than their face, but the maker and those claiming under him cannot limit the right of a subsequent holder to a recovery of what he may have paid therefor. In the case of Cromwell *v.* County of Sac, 96 U. S. 51, 60, in which it was held that the holder of such negotiable securities, regularly issued, is not limited to the amount which he may have paid therefor, it is said by the court, speaking by Mr. Justice FIELD: 'We are of opinion that a purchaser of a negotiable security before maturity, in cases where he is not personally chargeable with fraud, is entitled to recover its full amount against its maker, though he may have paid less than its par value, whatever may have been its original infirmity. We are aware of numerous decisions in conflict with this view of the law, but we think the sounder rule, and one in consonance with the common understanding and usage of commerce, is that the purchaser, at whatever price, takes the benefit of the entire obligation of the maker. Public securities, and those of private corporations, are constantly fluctuating in price in the market, one day being above par and the next below it, and often passing within short periods from one-half of their nominal to their full value. Indeed, all sales of such securities are made with reference to prices current in the market, and not with reference to their par value. It would introduce, therefore, inconceivable confusion if *bona fide* purchasers in the market were restricted in their claims upon such securities to the sums they had paid for them.'"

with resolutions of the stockholders authorizing the issuance of consolidated first mortgage bonds, all the stockholders assenting, in order to extend and improve the road, to take up and retire the first mortgage bonds and debenture bonds, and to cancel the first and debenture mortgages, issued to the holders of the latter consolidated first mortgage bonds, and took up at an agreed rate the debenture bonds purchased by those holders, and stock issued to them and to the iron company, and the first mortgage bonds and stock issued to the construction company, and subsequently sold to those holders by the construction company to enable it to complete the road. It was held in the action to foreclose the consolidated first mortgage, that subsequent purchasers from those holders of bonds of some of these consolidated first mortgage bonds were chargeable with notice of the prior bonds and mortgages, and of the terms on which the consolidated bonds were issued, and that, the railroad company acquiescing in the transaction, and no intention to defraud subsequent creditors being shown, these subsequent purchasers of the bonds could not impeach the prior indebtedness on which the bonds were issued, in order to invalidate the balance of the consolidated bonds held by the original parties.[1]

[1] Coe *v.* East & West R. Co. of Ala., (1892) 52 Fed. Rep. 531. It was said by the court: "The holders of the first consolidated bonds are charged with notice of the prior bonds and

A railroad corporation will not be allowed to show that restrictions imposed by its charter on its power to issue bonds were violated as against a *bona fide* holder of bonds issued by it, as such corporations, in general, have power to issue bonds.[1] The fact that bonds of a corporation which were legally pledged by authority of the directors for the purpose of carrying on construction work were, on foreclosure of the pledge, sold for a small amount, has been held not to affect the purchaser's title, no fraud being shown.[2] The remedies provided in a railroad mortgage given simultaneously with the issuing of the bonds for the better securing of which it is executed, will not affect the right of the bondholder to sue upon his bond at law, unless the provisions of the mortgage exclude this right of the bondholder in express terms or by necessary implication.[3] That it may be provided in a mortgage securing the bonds of a corporation that upon default in the interest the principal sum may be declared due, will not entitle the bondholder to sue upon his bond for the principal as due in case of default in interest. Such provisions have been held to apply only to the right to foreclose the mortgage.[4] It has

mortgages, and of the terms upon which their own bonds were issued. Caylus *v.* Railroad Co., 10 Hun, 295; Bronson *v.* Railroad Co., 2 Wall. 287, 311. This being the case, it is very doubtful whether complainants can impeach the indebtedness which existed prior to the issuance of their bonds, and upon which their bonds are based. At the time the first consolidated bonds were authorized and issued every interest consented, every bondholder, every stockholder, and the board of directors, and, so far as the record shows, every creditor; and the transaction was the consolidation of two series of bonds secured by mortgages of different dates into an equal number of bonds running a longer time, and bearing the same rate of interest, secured by one mortgage on practically the same property. Any and all the defects of construction, and all equities existing to the prejudice of the prior bonds, were waived and extinguished, and it was competent for the railroad company to make such waiver. See Bronson *v.* Railroad Co., *supra*. Even if the railroad company had been wronged or cheated, it would seem that subsequent creditors and subsequent purchasers have no right to question the transaction as long as the railroad company acquiesces, and no intention to defraud subsequent creditors is shown. See Graham *v.* Railroad Co., 102 U. S. 148. And the same case denies, in respect to such matters, that a corporation stands on any different footing from an individual debtor."

[1] Ellsworth *v.* St. Louis, Alton, etc., R. R. Co., 98 N. Y. 553; s. c., 33 Hun, 7.

[2] Wheelwright *v.* St. Louis, N. O. & O. Transportation Co., (1893) 56 Fed. Rep. 164.

[3] Manning *v.* Norfolk Southern R. Co., 29 Fed. Rep. 838.

[4] Mallory *v.* West Shore Hudson River R. R. Co., 3 Jones & S. 174; American Nat. Bank *v.* American Wood Paper Co., (R. I.) 32 Atl. Rep. 305. As to the right to recover on bonds issued, secured by a mortgage, though the corporation had no power to execute the mortgage, see Philadelphia & Sunbury R. R. Co. *v.* Lewis, 33 Pa. St. 33. That it may be proven by extrinsic evidence that certain bonds were the ones secured by a mortgage, see Butler *v.* Rahm, 46 Md. 541. As to bonds payable to a payee named "or assigns," see Bunting *v.* Camden & Atlantic R. R. Co., 81 Pa. St. 254. As to the right of a holder to fill in his name in a bond issued and delivered in blank as to the payee, and bring suit in his own name, see White *v.* Vermont & Massachusetts R. R. Co., 21 How. 575; Chapin *v.* Vermont & Massachusetts R. R. Co., 8 Gray, 575. As to the rights of a purchaser of bonds which may have been pledged for a loan by the corporation, see Grand Rapids & Indiana R. R. Co. *v.* Sanders, 54 How. Pr. 214. Of one who may have purchased stolen bonds, see Maas *v.* Missouri, Kansas & Texas Ry. Co., 11 Hun, 8. As to the effect upon a purchaser of bonds being overdue when he purchases them, see Vermilye *v.* Adams Express Co., 21 Wall. 138. As to the purchaser of bonds referring to the mortgage securing being bound by the statements contained in the mortgage, see Caylus *v.* New York, K. & S. R. R. Co., 10 Hun, 295. As to the rights of holders of bonds by their terms convertible into stock of the corporation issuing them, see Denney *v* Cleveland & Pittsburg R. R. Co., 28 Ohio St. 108; Sutliff *v.* Cleveland & Mahoning R. R. Co., 24 Ohio St. 147. When the issuing of such bonds will be enjoined, see Belmont *v.* Erie Ry. Co., 52 Barb. 637; Ramsey *v.* Erie Ry. Co., 38 How. Pr. 193.

been held in the United States Circuit Court for the southern district of Illinois that where overdue railroad mortgage bonds which belonged to the railroad company, were bought at forty cents on the dollar from the vice-president of the company after suit to foreclose the mortgage had been begun and a receiver had taken possession of the mortgaged property, the purchasers of such bonds were not *bona fide* holders, where inquiry on their part would have shown that the vice-president had no authority to sell the bonds.[1] It appearing in a suit to enforce the collection of railroad bonds which had been declared fraudulent that the bonds were given to a firm of which plaintiff was a member, in payment for work alleged to have been done for the railroad company, and that another member of the firm was an active participant in the fraud which rendered the bonds invalid, it was held that plaintiff was not an innocent holder.[2] In this suit to enforce the mortgage given by the corporation defendant there was an intervention by one who petitioned as the holder of certain bonds of the corporation for a recovery and a participation

[1] American Loan & Trust Co. *v.* St. Louis & Chicago Ry. Co., (1890) 42 Fed. Rep. 819.

[2] Smith *v.* Florida Central & Western R. R. Co., (1890) 43 Fed. Rep. 731.

in the security. It appeared that one acting as the agent of the intervener in loaning her money had fraudulently procured the making of a note by an irresponsible party payable to himself "as trustee," and, having connection with the corporation defendant, had fraudulently put in circulation these particular bonds, which he forwarded to her as collateral security for the payment of the note with the note not indorsed, she merely obtaining by the transfer an equitable title to the note. This note the federal court held was subject to equitable defenses in the hands of the petitioner, and that the fact that the note was held subject to equitable defenses rendered the bonds payable to bearer subject also to such defenses while in her hands as the note holder as collateral security for the note.[1] The United States Circuit Court for the district of Washington has sustained its jurisdiction to entertain the bill of a bondholder secured by the mortgage of a street railroad company's property to enjoin the construction of a sewer by the city which had granted the franchise to use its streets to the railroad company, holding that a mortgage upon a street railroad was as much entitled to protection from unlawful injury by such action on the part of a city as any other kind of property.[2]

§ 501. Holders of income bonds — rules as to an accounting with them.— Where mortgage bondholders seek an accounting by a railway company, the bonds of which they hold, the company will not be allowed to charge against income any payment or loss arising out of an antecedent debt; and the holder of

[1] Thomson-Houston Electric Co. *v.* Capitol Electric Co. (Read, Intervener), (1893) 56 Fed. Rep. 849, dismissing the intervener's petition. See Farmers' Loan & Trust Co. *v.* Oregon & W. T. R. Co. (Congdon, Intervener), (1893) 58 Fed. Rep. 639, where a contract for the sale of railroad bonds was held to include overdue coupons, it appearing that the contract contemplated a purchase of the railroad free from all indebtedness, and that the purchase of the bonds was merely a means to that end. It was also held that the intervener, who took an assignment of these overdue coupons with knowledge of the contract above referred to, was not a *bona fide* purchaser.

[2] Clapp *v.* City of Spokane, (1892) 53 Fed. Rep. 515; citing Morgan *v.* Gilbert, 2 Fed. Rep. 835–838. When the rights of bondholders are not affected by a subsequent fraudulent issue, see Union Trust Co. of New York *v.* Nevada & O. R. R. Co., 20 Fed. Rep. 80. As to the right of the holder of a bond guarantied by another corporation to recover upon default in payment by the one issuing the bond of the guarantor, see Harrison *v.* Union Pac Ry. Co., 13 Fed. Rep. 522. When bondholders are entitled to money coming into the hands of their trustees for their bonds, see Dwight *v.* Smith, 13 Fed. Rep. 50.

[1] Barry *v.* Missouri, Kansas, etc., Ry. Co., 27 Fed. Rep. 1.

[2] Barry *v.* Missouri, Kans. & Tex. Ry. Co., 34 Fed. Rep. 829.

coupons upon such bonds will be entitled to have the interest earned during each interest period applied upon the coupons representing that period.[1] Where a corporation has paid a higher rate of interest than needful on incumbrances prior to an income mortgage in an accounting in favor of the income bondholders, the corporation cannot charge the difference in interest against the income to the injury of the bondholders, in direct contravention of the provisions of the mortgage securing their bonds.[2] In an accounting between a railway corporation and the holders of its income bonds, where there was a provision made on the part of the corporation for retiring a series of secured income bonds and issuing new bonds in exchange, the bonds surrendered to be held by a trust company uncanceled until all were retired, a bondholder, who has not consented to surrender his bonds, would not be entitled in the accounting under the mortgage, to claim for interest due him more of the income than his share would have been had no bonds been surrendered.[3] The income mortgage bonds of a railway corporation in a New York case, issued after first consolidated mortgage bonds, were secured only so far as the principal of them was concerned, by the mortgage, the interest on them being payable out of net earnings as determined by the directors of the corporation. The Court of Appeals held that the directors of the corporation had the right, as against these income bondholders, to pay the bonds of a road leased by it, and the income bondholders had no lien on the road for the payment of their interest, and were bound by the decision of the directors as to net earnings.[4] Where an income mortgage to secure the payment of interest on income bonds was executed to cover the income of several roads constituting a system, and the company afterwards acquired additional roads, in a bill for accounting, it was held that the income fund referred to in this mortgage was confined to that of the roads specifically mentioned in the mortgage and not to that from the additional roads secured after its execution; that this was the income fund to which these bondholders were

[3] Barry *v.* Missouri, Kans. & Tex. Ry. Co., 34 Fed. Rep. 829.

[4] Day *v.* Ogdensburg & Lake Champlain R. R. Co., 107 N. Y. 129; 13 N. E. Rep. 765.

to look for the payment of their interest; that it was the duty of the company to keep separate accounts of the income and expenses of the different lines, and that it could not charge to the earnings of these specified lines of road the expenses or losses incurred in operating the additional lines of road acquired after the mortgage was given.[1]

§ 502. Detached, uncanceled coupons — rules governing. — When a third party with his own money takes up maturing coupons on bonds of a corporation, without knowledge of the holders, it is a question of fact, to be determined by the proof, whether it is intended to be a payment or a purchase which leaves the coupons outstanding. The coupons in this case having been dishonored before they came into the hands of the appellants, were subject in their hands to all defenses which existed against their assignor; and, it being evident that, without the knowledge of the holders of the bonds of this water works company, to which these coupons were attached, he used his money to pay the coupons on bonds which had been sold solely in order to enable him to float the rest of the issue, the Supreme Court of the United States held that it would be inequitable to allow him either a preference over those to whom he had sold the bonds or co-equal rights with them.[2] In a case before the Supreme Court of Michigan it appeared that the wife of a former promoter and president of a railroad company was bringing a suit against this company upon certain coupons which were past due and detached from bonds formerly issued by this company. The husband,

[1] Spies *v.* Chicago & Eastern Iowa Ry. Co., 40 Fed. Rep. 34.

[2] Wood *v.* Guarantee Trust & Safe Deposit Co., (1888) 128 U. S. 416; s. c., 9 Sup. Ct. Rep. 131. The court distinguished Ketchum *v.* Duncan, 96 U. S. 659, relied upon to support the denial that these coupons had been in fact paid. They said: "In Ketchum *v.* Duncan stress was laid on these circumstances, viz., that the persons alleged to have paid the coupons had no connection with the company issuing the coupons, or interest in it; that they had repeatedly and publicly notified the holders of the bonds and coupons that the coupons were to be purchased and not paid, and that the coupons were carefully received and preserved uncanceled." In Fidelity, etc., Company *v.* West Penn., etc., R. Co., (1891) 138 Pa. St. 494; s. c., 21 Atl. Rep. 21; 27 W. N. C. 267, the Supreme Court of Pennsylvania held that when interest coupons of mortgage bonds have been presented and paid at the place of payment, with money furnished by a third party, a private arrangement between such third party and the mortgagor that the transaction should be treated as purchase of the coupons by the former was not enforceable against the bondholders.

upon the idea that the bonds would sell better if they showed no unpaid past due coupons, had his wife clip them, and passed them to her without any consideration. He then sold those bonds with stock, he being the majority holder of the bonds and stock of the company, to a capitalist in New York that the latter might have control of the property. This capitalist afterwards sold the bonds and stock to one who was acting for the railroad company, complainant in the bill to enjoin the action upon these detached coupons. The parties in these various negotiations supposed that the sale of the bonds covered all the coupons attached and detached and not paid and canceled. Upon a review of the testimony in the case the Supreme Court held that such intention must prevail against the wife of the former president of the company, who was not an innocent purchaser for value, and that the coupons delivered to her must be considered as paid when cut from the bonds and so delivered.[1]

§ 503. Actions on coupons — rules governing. — A suit may be brought by the holder of overdue coupons and interest warrants, whether attached to or detached from corporation mortgage bonds, payable to bearer, and he may recover interest from the time they become payable.[2] An action in *assumpsit* may be brought by dissenting bondholders for the amount of unpaid

[1] Chicago & Grand Trunk Railway Co. *v.* Turner, (1889) 79 Mich. 133. For rules as to whether coupons detached from bonds and taken up are to be considered as paid or transferred, see Ketchum *v.* Duncan, 96 U. S. 659; Duncan *v.* Mobile & Ohio R. R. Co., 3 Woods, 567; Hand *v.* Savannah & Charleston R. R. Co., 17 S. C. 219; Miller *v.* Rutland & Wash. R. R. Co., 40 Vt. 399.

[2] Phil. & Read. R. R. Co. *v.* Smith, 105 Pa. St. 195; Phil. & Read. R. R. Co. *v.* Fidelity Ins. Trust, etc., Co., 105 Pa. St. 216. As to interest being recoverable on coupons overdue, see Ashuelot R. R. Co. *v.* Elliot, 57 N. H. 397; Langston *v.* South Carolina R. R. Co., 2 S. C. 248; Welsh *v.* St. Paul & P. R. R. Co., 25 Minn. 314; Gibert *v.* Wash. City, Va. Midland & Great So. R. R. Co., 33 Gratt. 586; Virginia *v.* Chesapeake & Ohio Canal Co., 32 Md. 501; North Pennsylvania R. R. Co. *v.* Adams, 54 Pa. St. 94. As to the negotiability of coupons, see Chesapeake & Ohio Canal Co. *v.* Blair, 45 Md. 102; Gilbough *v.* Norfolk & P. R. R. Co., 1 Hughes, 410; Haven *v.* Grand Junction R. R. & Depot Co., 109 Mass. 88; Hinckley *v.* Union Pac. R. R. Co., 129 Mass. 52; Evertson *v.* National Bank of New York, 66 N. Y. 14. As to actions on coupons, see Clark *v.* City of Janesville, 1 Biss. 98; Stevens *v.* N. Y. & Oswego Mid. R. R. Co., 13 Blatchf. 412; Burroughs & Springs *v.* Comrs., etc., 65 N. C. 234; City *v.* Lamson, 9 Wall. 477; County of Beaver *v.* Armstrong, 44 Pa. St. 63; Crosby *v.* New London, etc., R. R. Co., 26 Conn. 121; Clark *v.* Iowa City, 20 Wall. 583; Fitchett *v.* No. Pa. R. R. Co., 5 Phil. 132; Gelpcke *v.* City of

and overdue coupons upon their bonds notwithstanding the fact that a majority in interest of the bondholders secured by a mortgage may have consented to waive the rights secured by the mortgage.[1] The right of a bondholder to bring an action at law to recover on overdue interest coupons will not be affected by a provision in the mortgage executed by the corporation securing the bonds forbidding the holders of the bonds from proceeding at law or in equity to foreclose it, or procure a sale of the property independently of the trustee, although the mortgage provide for its foreclosure on default in the payment of the coupons.[2] Neither will the rights of the bondholder to such action at law upon his overdue interest coupons be affected by a waiver of the right to foreclose the mortgage on default in the payment of the interest coupons attached to the mortgage secured by it.[3] The Pennsylvania Supreme Court has declared these rules in actions upon coupons detached from bonds of a corporation secured by mortgage: Where an action is brought upon coupons it is not necessary to prove the execution of the mortgage securing the bonds to which the coupons were attached, particularly where a rule of court providing for an affidavit denying the execution of a writing sued upon has not been complied with. Recovery may be had upon coupons signed by the vice-president of the company, although the mortgage accompanying the bond provided that the bond should be signed by the president.[4] Where no affidavit has been filed denying proper execution, as provided by rule of court, evidence that the coupons were not properly executed will be excluded at the trial. And evidence that plaintiff entered into a written agreement with other creditors that they would take stock in the corporation for the principal of their debts is inadmissible.[5] The Statute of Limitations cannot be set up to prevent a recovery upon coupons which have not been detached from bonds; nothing can avail to defeat a recovery

Dubuque, 1 Wall. 175; Grand Rapids & Ind. R. R. Co. *v.* Sanders, 54 How. Pr. 214; Kennard *v.* Cass County, 3 Dill. 147; McCoy *v.* Washington County, 3 Wall. Jr. 381; McLendon *v.* Comrs., 71 N. C. 38; Nat. Exchange Bank *v.* Hart., Prov. & F. R. R. Co., 8 R. I. 375; Whitaker *v.* Hart., Prov. & F. R. R. Co., 8 R. I. 47; Welsh *v.* St. Paul & Pac. R. R. Co., 25 Minn. 314.

[1] Manning *v.* Norfolk Southern R. Co., 29 Fed. Rep. 838.

[2] Lyon *v.* New York, S. & W. R. Co., 14 Daly, 489.

[3] Ibid.

[4] Conshohocken Tube Co. *v.* Iron Car Equipment Company, (1894) 161 Pa. St. 391.

[5] Roberts & Co. *v.* Iron Car Equipment Co., (1894) 161 Pa. St. 348.

upon them but the presumption of payment which the law allows at the end of twenty years; and such presumption may be rebutted by evidence of non-payment.[1] In a case where bonds were issued by a railroad company, with interest payable annually, July first, with a provision that in case the net earnings of a portion of its road were not sufficient to pay the interest, scrip might, at the option of the company, be issued for it. In the absence of an exercise of the option by the company to issue the scrip for interest, as provided for, a federal court held that the holder of the bonds had an immediate right of action for his interest; it was also held that the acceptance of scrip for interest during some of the years by the bondholders did not amount to a waiver so as to prejudice this bondholder's rights in an action for interest on his bonds for subsequent years; further, that where the treasurer of the railroad company, shortly after the interest was due in these subsequent years, had notified the bondholders that the company could not pay the interest, but no action was taken as to the scrip, no demand on the part of this bondholder for the payment of his interest was necessary before action to entitle him to a recovery.[2]

§ 504. Guaranty of bonds of one corporation by another — rules.—A railroad corporation, vested with power by its charter to issue its own bonds, may guarantee the bonds of another railroad corporation received by it in payment of a debt, and sold for value or transferred in payment of its own debts, such guaranty being given to improve the credit of the bonds or to obtain an adequate price for them.[3] In this foreclosure suit there was presented to the United States Circuit Court of Appeals the question whether a land company, a corporation which guaranteed the mortgage bonds of the railroad company, defendant in the suit, and afterwards joined the railroad company in borrowing money with which to pay the interest coupons upon these bonds, should not have been a party to this suit. The appellate court held that by this original guaranty and borrowing in connection with the railroad company the money to pay the interest coupons

[1] Phila. Trust Co. *v.* Phila. & Erie R. R., (1894) 160 Pa. St. 590.

[2] Texas & Pac. Ry. Co. *v.* Marlor, 8 Sup. Ct. Rep. 311.

[3] Rogers Locomotive & Machine Works *v.* Southern Railroad Association, 34 Fed. Rep. 278.

the land company did not become subrogated *pro tanto* to the rights of the mortgagee, so as to become an indispensable or even a proper party to the subsequent foreclosure suit, as subrogation does not take place until the payment of the whole debt for which the surety is liable. The contention of the appellant, it was argued, rested upon a provision in the charter of the railway company to this effect: "And in order to enable said company [the land company] to guarantee the punctual payment of the interest and principal of such bonds, it is hereby expressly declared that the guarantors of such bonds shall be entitled to all the benefits of such mortgage or deed of trust made to secure such bonds to the same beneficial extent that the holders of said bonds may be entitled." The appellate court held that this provision in the charter of the railway company was a mere declaration of the principles of subrogation, and could not be construed as placing the guarantors, who had made only a partial payment, upon an equal footing with the mortgage creditors.[1] The jurisdiction of a court of equity of a bill brought by a railroad corporation to cancel its guaranty upon the bonds of another corporation, on the ground of illegality and fraud, has been sustained by the United States Circuit Court for the district of Kentucky. The court held, in the first place, that the bill was not demurrable because it failed to show that the defendants were not *bona fide* holders for value, as when fraud or illegality on the inception of negotiable instruments is shown it devolves upon the indorsee to show that he is a *bona fide* holder. The main point on which the jurisdiction of the court was placed was that such a bill against the holders of the bonds to cancel the guaranty was maintainable in equity on the ground of preventing a multiplicity of suits, although it might have a good defense at law to each of the bonds.[2]

[1] Columbia Finance & Trust Co. *v.* Kentucky Union Ry. Co., (1894) 60 Fed. Rep. 794. The court distinguished Railroad Co. *v.* Schutte, 103 U. S. 141.

[2] Louisville, N. A. & C. Ry. Co. *v.* Ohio Valley Improvement & Contract Co., (1893) 57 Fed. Rep. 42. The guaranty of the railroad company was alleged to have been indorsed upon the bonds of the improvement company illegally and fraudulently. LURTON Circuit Judge, reviewed cases involving the principles as follows: "The case of Railway Co. *v.* Schuyler, 17 N. Y. 592, is an interesting and instructive case. In that case it appeared that spurious certificates of stock in a railroad corporation had been issued by an officer having apparent authority to do so, and undistinguishable on their face from certificates of genuine stock, and were outstanding in the hands of numerous holders. The holders of such spurious certificates were made parties defendant to the bill filed by the railroad company. After an elaborate consideration of the question, as to whether or not the bill would lie, that court maintained its jurisdiction and held that the false certificates, having a common origin and common ground of invalidity, though the holders became such under different circumstances and conveyances, and claimed different rights, yet they were all properly joined as defendants and the bill maintained as a bill to prevent a multiplicity of suits. In Supervisors *v.* Deyoe, 77 N. Y. 219, we find a similar case. The treasurer of Saratoga county, under an authority to issue notes for money advanced to the county to the amount of some $20,000, issued seventy-three notes to the amount of one hundred and thirty-eight thousand dollars. These notes were held by fifty-three persons, many of whom had brought separate suits upon their notes. The supervisors filed a bill in equity against all the holders of said notes, including those who had brought suits at law. Upon demurrer to the bill it was held that upon the facts a case was made entitling the plaintiff, upon equitable principles, to implead the holders of the notes for the purpose of having their respective rights and the liability of the [county?] determined in one action; that the claims were of the same general character, and that the action was maintainable for the purpose of preventing a multiplicity of suits and to protect plaintiff against the hazard of a double recovery. The case of Waterworks *v.* Yeomans, L. R., 2 Ch. App. 11, was this: A very large number of persons held separate claims against the waterworks company. The claims were for damages originating in an inundation resulting from the breaking of a reservoir. Under a special act commissioners were appointed to inquire into and assess these damages and issue certificates

§ 505. Lease of a bonded railroad — when lessee is not bound on the bonds.— An Iowa railroad company, by action of its directors, made a lease of its road to a second Iowa company for forty years. This latter company afterwards entered into a contract of its road and the leased road to an Illinois corporation, a railway company, for twenty years. The first-mentioned lessor company had, previously to the lease of its road, issued bonds which were sold and the proceeds used in the construction of its road, and executed a mortgage to certain trustees to secure these bonds. The mortgage covered the company's road, and the net earnings thereof, its franchises, privileges, right of way, depot grounds, and all material designed to be used in construction; also, "the rents and moneys payable by any person or company" to that corporation "for the use of said road and its appurtenances." By its contract with the lessee company the Illinois company assumed the lease made by this lessee with the lessor company. When the bonds were sold upon the market there was indorsed

upon them and signed by the president of the lessor company this statement: "The lease of the [lessor company's road] to the [first-named lessee], referred to in the within bond, has this day been assumed by the [Illinois railroad company], and the minimum rent which that company has thereby obligated to pay in monthly installments is more than sufficient to meet the entire amount of interest on this issue of bonds." The road of the mortgagee company went into the control of the Illinois company, which paid the fixed rental, but, having obtained control of the company during the term of lease from which it had leased the mortgaged road, at the end of the twenty years of its lease, returned the road to the second company. The surviving trustee of the mortgage of the lessor company brought a bill in equity, charging that the course of the Illinois company in neglecting to perform the covenants of its lease, and to account for the earnings and income of the mortgaged railroad, had caused the mortgagee to default in the payment of the bonds and coupons, and the mortgagee being insolvent and without resources, other than its leased property, had failed to collect and properly apply the income, rents and profits of the mortgaged property, and had misapplied some portions of them; and that a foreclosure and sale of the mortgaged property, before the obligation which the Illinois company had assumed, should be enforced, would be injurious to the mortgagee company and its stockholders, as well as the bondholders. The trustee sought to obtain, by a decree of the court, the control of the rents and income under the contract of lease. As to the Illinois company, the United States Circuit

upon the several claims. The waterworks claimed that the power of the commissioners had expired, and that a large number of these certificates were in consequence invalid. A bill by the company against a few as representing the whole number was filed and a demurrer sustained. The Court [of Appeals] held that as the rights of all depended upon the same question, and that, although the defense could be made at law, it was 'a very fit case, by analogy at least, to a bill of peace, for a court of equity to interpose and prevent the unnecessary expense and litigation which would be thus occasioned, and to decide once for all the validity or invalidity of the certificates upon which the claims of all persons depend.'" See, also, Black *v.* Shreeve, 7 N. J. Eq. 440. As to guaranty of bonds, see Low *v.* California Pac. R. R. Co., 52 Cal. 53; New Haven, M. & W. R. R. Co. *v.* Town of Chatham, 42 Conn. 465; Arnot *v.* Erie Ry. Co., 67 N. Y. 315; Toppan *v.* Cleveland, Col. & Cin. R. R. Co., 1 Flip. 74; Opdyke *v.* Pacific R. R. Co., 3 Dill. 55; Codman *v.* Vermont & Canada R. R. Co., 16 Blatchf. 165.

Court held that as the rentals for this road had been fully paid by that company to the mortgagee company to the date on which its road was surrendered to the original lessee before the commencement of the suit, there was no ground whatever for a decree against that corporation, and as to that company the original suit was ordered dismissed.[1]

[1] Jesup *v.* Illinois Central R. R. Co., (1890) 43 Fed. Rep. 483. It was further held that there was nothing in the indorsement made upon the bonds as to the assumption of the contract of lease by this company to estop it from denying its liability in this action.

CHAPTER XXVI.

MORTGAGES AND TRUST DEEDS — PRIVATE CORPORATIONS.

§ 506. Power of corporations to execute mortgages and trust deeds upon their property.
507. Statutes requiring assent of stockholders to mortgages construed.
508. Mortgages and trust deeds — rules to as place of execution, authorization — mode of execution, to whom executed, record, etc.
509. Estoppel of corporation to deny authority of officers to mortgage.
510. Effect of laches of corporation in repudiating a mortgage.
511. What are reasonable provisions in a mortgage.
512. Chattel mortgages of corporations.
513. Deeds of trust and mortgages securing directors — when properly given.
514. The validity of mortgages as affected by restrictions, constitutional, statutory, or in charter upon indebtedness to be incurred.
515. A mortgage of corporation property to pay purchase-money debts.
516. Illustration of an equitable mortgage.
517. Mortgage of a consolidated railroad company — estoppel to claim its invalidity on the ground that the consolidation was not legally perfected.
518. Illustration of a fraudulent mortgage.
519. What corporation mortgages cover, and what they do not cover.
520. Trustees of such mortgages — their duty, rights and powers.

§ 506. Power of corporations to execute mortgages and trust deeds upon their property.— Corporations, it is well settled, have the power to sell their property, real and personal, and to mortgage it for the security of their debts, as an incident to the power of acquiring and holding such property. This right exists by common law, but may be limited by statute, or by the laws or charters under which such corporations are organized.[1]

[1] Fitch *v.* Lewiston Steam Mill Co., (1888) 80 Me. 34; s. c., 12 Atl. Rep. 732. See Pierce *v.* Emery, 32 N. H. 503; Richards *v.* Merrimack & Connecticut River Railroad, 44 N. H. 135. As to power to mortgage, see Thomas *v.* Citizens' Horse Ry. Co., 104 Ill. 462; McAllister *v.* Plant, 54 Miss. 106; Pullan *v.* Cin. & Chicago Air Line R. R. Co., 4 Biss. 35; Campbell *v.* Texas & N. O. R. R. Co., 2 Woods, 263; Branch, Sons & Co. *v.* Atlantic & Gulf R. R. Co., 3 Woods, 481; Coe *v.* Col., Piqua & Indiana R. R. Co., 10 Ohio St. 372; Central Gold Mining Co. *v.* Platt, 3 Daly, 263; Willink *v.* Morris Canal & Bkg. Co., 4 N. J. Eq. 377; Allen *v.* Montgomery R. R. Co., 11 Ala. 437; Covey *v.* Pittsburg, Ft. Wayne & Chicago R. R. Co., 3 Phil. 173; Dunham *v.* Isett, 15 Iowa, 284; Bardstown & Louisville R. R. Co. *v.* Metcalfe, 4 Metc. (Ky.) 199; Hays *v.* Galion Gas Light & Coal Co. 29 Ohio St. 330; Kennebec & Portland R. R. Co. *v.* Portland & Kennebec R. R. Co., 59 Me. 9; Loudenslager *v.* Benton, 4 Phil. 382; McCurdy's Appeal, 65 Pa. St. 290; Miller *v.* Rutland & Washington R. R. Co., 36 Vt. 452; Ludlow *v.* Hurd, 1 Disney, 552; Mobile & Cedar Point R. R. Co. *v.* Talman, 15 Ala. 572; Racine & Mississippi R. R. Co. *v.* Farmers' Loan & Trust Co., 49 Ill. 331; Richards *v.* Merrimack & Connecticut River R. R. Co., 44 N. H. 127; Coe *v.* New Jersey Midland Ry. Co., 31 N. J. Eq. 105; McLane *v.* Placerville & Sacramento Valley R. R. Co., 66 Cal. 606; Duncomb *v.* New York, H. & N. R. R. Co., 84 N. Y. 190; Gordon *v.* Preston, 1 Watts, 385; Burt *v.* Rattle, 31 Ohio St. 116; Jackson *v.* Brown, 5 Wend. 590; Reynolds *v.* Stark County, 5 Ohio, 205; State *v.* Rice, 65 Ala. 83; Pennock *v.* Coe, 23 How. 117; Shaw *v.* Bill, 95 U. S. 10; Howe *v.* Freeman, 14 Gray, 566; Ellis *v.* Boston, H. & E. Railroad, 107 Mass. 1; Da Ponte *v.* Northern Pac. R. R. Co., 21 Blatchf. 534; Mead *v.* New York, H. & N. R. R. Co., 45 Conn. 199; Bell *v.* Chicago, St. L. & N. O. R. R. Co., 34 La. Ann. 785; Scott *v.* Clinton & S. R. R. Co., 6 Biss. 529.

The United States Circuit Court of Appeals has held that an Ohio railway corporation may mortgage after-acquired property, acquired either by itself or by any successor in title exercising the same franchises or similar franchises granted by the same sovereign power.[1] A Pennsylvania railroad company was empowered by its charter to "purchase, receive, have, hold, and enjoy, to them and to their successors and assigns, lands, tenements, hereditaments, goods, chattels, and all estate, real, personal, and mixed, of what kind or quality soever, and the same from time to time to sell, mortgage, grant, alien or dispose of," etc. In a case before the Supreme Court of that state, the question was raised as to the power of this company to execute a mortgage upon its property. Referring first to the provision of the charter quoted above, the court said: "The power to mortgage is given in the most explicit language, and embraces all the property which the company may acquire or hold 'real, personal, and mixed, of what kind or quality soever.' It is difficult to conceive how there could be a larger or more comprehensive description of the kind of property upon which the power to mortgage could be exercised than is contained in these words. They embrace every species of property known to the law; and the power itself is not subjected to any limitations, restrictions or

[1] Compton *v.* Jesup, 68 Fed. Rep. 263. As to the power of a gas company to mortgage its entire property to secure bonds and floating indebtedness, see Hunt *v.* Memphis Gas Light Co., (Tenn.) 31 S. W. Rep. 1006. As to the limitations on the power of a railroad corporation under the New Jersey statutes to mortgage its property, see Baker *v.* Guarantee Trust & Safe Deposit Co., (N. J. Eq.) 31 Atl. Rep. 174.

qualifications of any kind. No provision is made as to the manner in which the power should be exercised, and hence no particular formalities were required to be observed. An authentic act of execution by the proper officers of the company would seem, therefore, all that was necessary to a valid exercise of the power. We cannot assent to the contention that, in addition to the power to mortgage, there must also be expressed a specific authority to borrow money and issue bonds therefor. The manifest purpose of a mortgage is to secure loans of money, and the power to borrow money and to give the ordinary evidences of loans in the form of bonds, or other obligations to the same effect, is a necessary incident to the power to mortgage. But it is also the necessary incident to the right to build a railroad; and it is only essential to have the power to mortgage expressly granted, in order that it may be exercised for the purpose of securing indebtedness, whether arising from loans of money or upon other considerations. Nothing to the contrary of this was decided in the case of Pittsburgh R. Co. *v.* Allegheny County, 63 Pa. St. 126. Additional power to mortgage was granted to this company by [the following] section of [a subsequent act of the legislature], in these words: 'And the said railroad company are hereby authorized to mortgage or otherwise incumber their said road and any real and personal estate which may belong to it, for the purpose of carrying out the privileges granted by the act and the several supplements thereto incorporating the same.'" The court said: "It was contended for the appellants that this power was limited to the purpose of carrying out the privileges granted by the incorporating and supplementary acts, and that those privileges were exhausted when the road as then built was finished. By [another] section of the same act the company was authorized to extend their road to any point they may select in [certain named] counties, so as to form a connection with [a certain named railroad], or any other railroad that may be constructed. Other powers of extension were granted by previous and subsequent legislation. The power to mortgage clearly included the railroad and all other real and personal estate of the company, without reference to the time of its acquisition, so long as the purpose was observed of carrying out the privileges of the company granted by the original act of incorporation, or any supplements thereto. So long as the acts done or supposed to be done are within the legalized powers of the company, whether

before or subsequent to the passage of this act, the power to mortgage attaches. We cannot agree that it was restrained to the mere physical structure then completed. If a subsequent acquisition of rolling stock should become necessary, or the erection or lawful acquisition of branches, in addition to those already possessed, should take place, it cannot be doubted that the power to mortgage, conferred by this act would be applicable."[1] A railroad company of Tennessee, the charter of which empowered it to mortgage for the purpose of completing its road and equipping it with everything necessary to give it full operation, was held by the Supreme Court of that state not to be thereby authorized to execute bonds and mortgage for any other purpose than that of completing and equipping the original line of road authorized by the charter. They further held that a mortgage by this company, executed within twenty-five years after the completion and equipment of its road, and not purporting to have been executed for any such purpose, or to secure the renewal of bonds originally issued for those purposes, could not be presumed to have been executed for the purposes named in the charter.[2] The Supreme Court of the United States has held that a manufacturing corporation of New York, having authority to mortgage its property for the purpose of carrying on its business, is not prohibited by the laws of that state from executing such a mortgage to secure the payment of money to be thereafter advanced.[3]

[1] Gloninger *v.* Pittsburgh & Connellsville R. R. Co. 139 Pa. St. 13; s. c., 21 Atl. Rep. 211; 27 W. N. C. 497.

[2] Frazier *v.* East Tennessee, Va. & Ga. R. R. Co., 88 Tenn. 138; s. c., 12 S. W. Rep. 537. In Belden *v.* Burke, 72 Hun, 51; s. c., 25 N. Y. Supp. 601, it was held that no statute being contravened and the stockholders not resorting to any deception or fraud to attract investors to purchase the mortgage bonds, those who have acquired all the stock of a corporation had a legal right to cause the corporation to mortgage its property in an amount exceeding its value. See Brown *v.* Supply Co., 23 Or. 541; Nelson *v.* Hubbard, 96 Ala. 238; Adams Cotton Mills *v.* Dimmick, 96 Ala. 238; Grant *v.* Railroad Co., 13 U. S. App 1; s. c., 4 C. C. A. 511; Robinson *v.* Land Co., 2 Colo. App. 17.

[3] Jones *v.* Guaranty & Indemnity Co., (1879) 101 U. S. 622. Mr. Justice SWAYNE, speaking for the court, said, as to the power of corporations respecting the execution of mortgages: "At the common law every corporation had, as incident to its existence, the power to acquire, hold and convey real estate, except so far as it was restrained by its charter or by act of parliament. This comprehensive capacity included, also, personal effects of every kind. The *jus disponendi* was without limit or qualification. It extended to mortgages given to secure the payment of debts. 1 Kyd

The Court of Appeals of New York in a fully considered case has sustained the validity of a mortgage given by a manufacturing corporation covering all of its real and personal property. In this case Rapallo, J., has thus stated the views of that court as to the construction of the statutes of that state of 1864 and 1871 on the subject and the powers conferred by them on the corpora-

Corp. 69, 76, 78, 108; Ang. & A. Corp. § 145; 2 Kent Com. 282; Reynolds *v.* Commissioners of Stark County, 5 Ohio, 204; White Water Valley Canal Co. *v* Vallette, 21 How. 414. A mortgage for future advances was recognized as valid by the common law. Gardner *v.* Graham, 7 Vin. Abr. 22, pl. 3. See, also, Brinkerhoff *v.* Marvin, 5 Johns. Ch. 320; Lawrence *v.* Tucker, 23 How. 14. It is believed they are held valid throughout the United States, except where forbidden by the local law. The statute under which the oil company [the mortgagor] came into existence made it 'capable in law of purchasing, holding and conveying any real and personal estate, whenever necessary to enable' it to carry on its business, but it was forbidden to 'mortgage the same or give any lien thereon.' This disability was removed by the later act of 1864, which expressly conferred the power before withheld. This change was remedial, and the clause which gave it is, therefore, to be construed liberally with reference to the ends in view. The learned counsel for the appellant insisted that a mortgage could be competently given by the oil company only to secure a debt incurred in its business and already subsisting. This, we think, is too narrow a construction of the language of the law. A thing may be within a statute but not within its letter, or within the letter and yet not within the statute. The intent of the lawmaker is the law. People *v.* Utica Insurance Co., 15 Johns. 357; United States *v.* Babbit, 1 Black, 55. The view of the court in Thompson *v.* New York & Harlem Railroad Co., 3 Sandf. Ch. 625, was sounder and better law. There the charter authorized the corporation to build a bridge. It found one already built that answered every purpose and bought it. The purchase was held to be *intra vires* and valid. Here the object of the authorization is to enable the company to procure the means to carry on its business. Why should it be required to go in debt, and then borrow, if it could, instead of borrowing in advance, and shaping its affairs accordingly? No sensible reason to the contrary can be given. If it may borrow and give a mortgage for a debt antecedently or contemporaneously created, why may it not thus provide for future advances as it may need them? This may be more economical and more beneficial than any other arrangement involving the security authorized to be given. In both these latter cases the ultimate result with respect to the security would be just the same as if the mortgage was given for a pre-existing debt in literal compliance with the statute. No one could be wronged or injured, while the corporation, whom it was the purpose of the law to aid, might be materially benefitted. Is not such a departure within the meaning, if not of the letter, of the statute? There would be no more danger of the abuse of the power conferred than if it were exercised in the manner insisted upon. The safeguard provided

tion in these words: "Where money is lent to an individual or to a corporation authorized to borrow money, and the borrower at the time of the loan delivers his bond and mortgage as security for the repayment of the money so loaned, it can hardly be questioned that the bond and mortgage are given to secure a debt contracted by the borrower. [These statutes] declare that where the requisite consent of stockholders is given, the mortgage shall

in the required assent of stockholders would apply with the same efficacy in all the cases. The object of the loan, the application of the money, and the restraints imposed by the charter in those particulars, would be the same whether the transaction took one form or the other. According to our construction the company could give no mortgage but one growing out of their business, and intended to aid them in carrying it on. In legal effect the difference between the two constructions is one merely of mode and manner, and not of substance. Such securities are not contrary to the law or public policy of the state [of New York]. Many cases are found in her reported adjudications where both judgments and mortgages for future advances have been sustained. Our view is not without support from the language of the statute, that 'every mortgage so made shall be as valid to all intents and purposes as if executed by an individual owning such real estate.' If this mortgage had been given by individuals, the question we are examining doubtless would not have been brought before us for consideration. * * * When a deed is fatally defective for the want of a sufficient consideration to support it, such a consideration subsequently arising may cure the defect and give the instrument validity. Sumner *v.* Hicks, 2 Black, 532. It is not necessary to go through the form of executing a second deed to take the place of the first one. This principle applies to the mortgage after all the advances had been made, conceding that it had before been invalid for the reason insisted upon. The statute of 1864 neither expressly forbids nor declares void mortgages for future advances. If the one here in question be *ultra vires*, no one can take advantage of the defect of power involved but the state. As to all other parties, it must be held valid, and may be enforced accordingly. Silver Lake Bank *v.* North, 4 Johns. Ch. 370; National Bank *v.* Matthews, 98 U. S. 621. In the latter case this subject was fully examined. A corporation can act only by its agents. If there were any such technical defect as is claimed touching the execution of this mortgage, it has been cured by acquiescence and ratification. No no else can raise the question. All other parties are concluded. Gordon *v.* Preston, 1 Watts (Pa.), 385. Where money had been obtained by a corporation upon its securities, which were irregular and *ultra vires*, but the money was applied for the benefit of the company, with the knowledge and acquiescence of the shareholders, the company and the shareholders were estopped from denying the liability of the company to repay it. And the same result follows where such securities are issued with the knowledge of the shareholders, so far as the money thus raised is applied for the benefit of the company. In re Cork & Youghal Railway Co., Law Rep., 4 Ch. 748. A court of equity abhors forfeitures and will not lend its aid to enforce them. Marshall *v.* Vicksburg, 15 Wall. 146. Nor will it give its aid in the assertion

be as valid to all intents and purposes as if executed by an individual. The only other restriction is that the debt secured by the mortgage must be one contracted in the business for which the corporation was incorporated. There is nothing in the statute which requires that it should have been contracted at any particular time. If it is contracted simultaneously with the giving of the security, and is a legitimate debt incurred in the business of the company, it comes within the letter of the authority conferred by the statute which covers 'any debt which may be contracted by it in the business for which it is incorporated.' As to a mortgage given to secure future advances, different questions might arise, but where a bond secured by mortgage is given to the lender for money advanced at the time, the borrower becomes immediately indebted, and it would seem to be immaterial whether the money is applied by the borrower to the payment of some antecedent debt or to other purposes for which he was legitimately entitled to borrow the money. The only conceivable intent which could be attributed to the legislature of requiring that the power of mortgaging should be confined to the securing of debts other than those created simultaneously with the giving of the security would be to put it beyond the power of the trustees or directors, even with the assent of the stockholders, to borrow money not needed for the payment of previously existing debts, and thus obtaining the control of funds which they might misapply. I fail to find any language in the act expressive of such intent. It likens the power given to these corporations to that of an individual to mortgage his own property, to secure any debt which he may contract, and there is no restriction upon this power except that the assent of stockholders must be obtained." [1]

of a mere legal right contrary to the clear equity and justice of the case. Lewis *v.* Lyons, 13 Ill. 117."

[1] Lord *v.* Yonkers Fuel Co., (1885) 99 N. Y. 547. Referring to leading cases, it was said: "In Greenpoint Sugar Co. *v.* Whitin, 69 N. Y. 328, it is said by CHURCH, Ch. J., at page 333, that the act of 1864 removed the restriction substantially imposed by the act of 1848, with a proviso requiring only that those interested, the stockholders, should consent, thus plainly evincing that the purpose and intent were to protect the stockholders from improvident or corrupt acts by the officers of the company; that there is nothing showing that the legislative policy regarded the mortgaging of corporate property improper *per se*, but the policy adopted indicates a fear of its improper exercise and an intention to guard against it. And again at page 334, that the act of mortgaging is not deemed illegal, but the principal must assent in writing. In that case the mortgage was given to secure the purchase price of real estate conveyed to the company by the mortgagee on the same day the mortgage was executed, but which had been previously occupied by the company under a contract of purchase. In Rochester Savings Bank *v.* Averell, 96 N. Y. 467, the mortgage was given to secure $10,000 borrowed by the company from the bank at the time of the execution of the mortgage. The feature existed in that case that the money was borrowed to pay certain debts of the company and was so applied. The question did not arise in that case as to what the result would have been in the absence of that feature. Adopting the comparison suggested by the statute, with the act of an individual mortgaging his own property to secure the payment of his own debt, and supposing the case of a principal, having an agent authorized to borrow money to be used in the business of the principal, and that the principal should under that state of existing circumstances give a power of attorney to the agent empowering him to secure the payment of 'any debt theretofore contracted, or which might be contracted by him in the business' of the principal, by mortgage on his real estate, can it be doubted that a mortgage given by the agent to secure money borrowed by him in the business of his principal, simultaneously with the giving of the mortgage security, would be within the terms of the power? I can see no reason for applying a different rule of construction to an authority in the same words contained in a statute. But in the present case we are not under the necessity of deciding that question or determining what the result would have been if the bonds had been sold, or money raised thereon by the company for purposes other than the payment of existing debts. It appears from the findings, not only that the money paid to the company for the bonds was used in the payment of its debts, but that the money was so paid by the bondholders to the company only as its other existing debts became due. The bonds secured by the mortgage did not acquire vitality until they were issued to purchasers paying value therefor, and did not until then become liens upon the mortgaged property. Consequently, when the mortgage lien was created, it was, as to each bond issued, created for the purpose of paying debts then owing by the company and was so applied. There is nothing in the act which requires that in the case of a trust mortgage to secure negotiable bonds to be thereafter issued, the debts authorized to be secured should be in existence at the time the mortgage and bonds are prepared and executed. Every conceivable intent of the statute is effectuated, provided the bonds are negotiated only for the purpose of securing or paying debts contracted before the negotiation of the bonds. Where a

§ 507. Statutes requiring assent of stockholders to mortgages construed.—The act of the state of New York of 1867, with reference to the execution of mortgages by manufacturing corporations, was succeeded by a further amendatory act of the statute of 1848, the act of 1872, whereby such corporations were authorized to purchase, hold and convey any real or personal estate necessary to enable them to carry on their cor-

porate operations, and also to borrow such sums of money, not exceeding one-half of their capital, as might be necessary to carry on their business, and to issue and dispose of their bonds for any amount so borrowed and mortgage the corporate property and franchises of the company to secure the payment of any debt contracted by it for the purposes aforesaid. The Court of Appeals held that the obvious effect of the last act was to supersede the provisions of the law of 1867 requiring the assent of two-thirds of the stockholders of a corporation as a condition to the exercise of the right to mortgage and to enlarge the power of a corporation to mortgage, so as to include personal property and franchises as well as real estate, and to cover the payment of all debts contracted for the legitimate operations of the corporation. In this particular case a gas light company purchased the property described in the mortgage of the plaintiff, agreeing to pay therefor $50,000 in cash and $200,000 in the stock of the company, and he accepted the mortgage in lieu of the cash payment. The court held it was competent for him to do so without impairing the validity of the mortgage, and for the company to transfer the mortgage to him in lieu of the money which it was authorized to borrow for the purpose of making such payment. "The result," it was said, "accomplished by this transaction was the precise equivalent of a delivery to a creditor to secure a loan, and did not constitute a diversion of the mortgage from its intended object. The agreement of purchase created a debt, and the purpose of its creation being to enable the company to carry on its business operations, the transaction was brought within the terms of the statute authorizing such a corporation to mortgage its property." Again it is said: "The power to purchase property for the purposes of the corporation, and, if necessary, to contract

bond of this description, having no previous vitality, is delivered to a creditor of the company to pay or secure his debt, the delivery of the bond is the act by which his debt becomes secured. The security to the creditor then for the first time comes into being, and is as effectual as if the mortgage were executed at the same time with the delivery of the bonds. The effect is the same if the bond is sold to provide means to pay a debt existing at the time of the sale, and the proceeds are paid to the creditor. As held in the case of Carpenter *v.* Black Hawk Co., 65 N. Y. 43, the statute prescribes no form in which the mortgage shall be made. The mode in which the mortgage lien shall be created is left to the company. All that is required is that the lien should be given to secure a legitimate debt of the corporation, and any appropriate and convenient form for accomplishing that end may be adopted."

a debt therefor, is expressly given to the corporation, and authority to mortgage its property for the payment of such debt is clearly within the spirit as well as the letter of the statute."[1] Bills in equity were filed, one by a stockholder and others by unsecured simple contract creditors, in a court of Massachusetts to prevent the sale under power in a trust deed or mortgage of the property of a heating company, a corporation of that state, given to secure certain bonds which the heating company had issued and used in securing advances of money for carrying out its purposes. This brought in question the power of such a corporation in that state to make a mortgage such as it had executed in these cases. The Supreme Judicial Court held that the heating company was clothed with power under the laws of Massachusetts to execute the mortgage.[2] In a case where the manu-

[1] Davidson *v.* Westchester Gas Light Co., (1885) 99 N. Y. 558, 563, 564, 565.

[2] Evans *v.* Boston Heating Co., (1892) 157 Mass. 37. *Arguendo* it was said: "The general power of a railroad company, which is undoubtedly a public or a *quasi* public corporation, to make a mortgage of its property, was much discussed by this court in Commonwealth *v.* Smith, 10 Allen, 448. It was there held that such a company, which was created for the sole purpose of constructing, owning and managing a railroad, and authorized to take land under the power of eminent domain, could not make a mortgage in a manner impliedly prohibited by statute; and it was said that there were innumerable objections to such a corporation alienating its franchise and conferring its powers and privileges upon another person or body without authority other than that derived from the fact of its own incorporation. It was also said: 'The power to mortgage can only be coextensive with the power to alienate absolutely, because every mortgage may become an absolute conveyance by foreclosure.' And in Richardson *v.* Sibley, 11 Allen, 65, it was held that under the statute of 1864, chapter 229, section 24, providing that no street railway corporation shall sell or lease its road or property unless authorized so to do by its charter or by special act of the legislature, such a corporation could not mortgage its property." They then said: "The doctrine of these cases does not apply to ordinary trading or manufacturing corporations. Thus, in Treadwell *v.* Salisbury Manuf. Co., 7 Gray, 393, it was held that the directors of a manufacturing corporation might, pursuant to the votes of a majority of its stockholders, though against the protest of the minority, sell the entire property of the corporation to a new corporation. The distinction between such corporations and 'corporations established for objects *quasi* public, such as railway, canal and turnpike corporations to which the right of eminent domain and other large privileges are granted in order to enable them to accommodate the public, was pointed out on page 404 by Mr. Justice Bigelow. And in Commonwealth *v.* Smith it was said by Mr. Justice Hoar: 'The general power to dispose of and alienate its property is also incidental to every corporation not re-

facturing company had executed a mortgage for a large amount to secure a balance of indebtedness due for the purchase price of real estate and for advances made for erecting the buildings of the company, there was a question of whether the paper signed by stockholders, either expressly or by legal intendment, was sufficient to manifest a consent to this mortgage. The paper referred to expressly consented that the company execute to the

stricted in this respect by express legislation or by the purposes for which it is created, and the nature of the duties and liabilities imposed by its charter.' 10 Allen, 455. The policy of the commonwealth in regard to railroads and street railways as set forth in the cases above cited has since been changed. The statute of 1874, chapter 372, section 49, provided: 'Any railroad corporation, by a vote at a meeting called for the purpose, may issue bonds to provide means for funding its floating debt or for the payment of money borrowed for any lawful purpose.' This was amended by the statute of 1875, chapter 58, section 1, by adding the words, 'And may mortgage or pledge as security for the payment of such bonds any part or all of its road, equipment or franchise, or any part or all of its property, real or personal.' These provisions are incorporated in the Public Statutes, chapter 112, section 62. By the statute of 1889, chapter 316, a power is given to a street railway company by a vote of a majority in interest of its stockholders, to authorize the issue of coupon or registered bonds, 'secured by a mortgage of a part or of the whole of the railway of such company and its equipments, franchise and other property, real and personal.' By the statute of 1870, chapter 224, the legislature passed a general law authorizing the formation of various kinds of manufacturing and trading corporations, including in section 5 those for the purpose of making and selling gas for light in a city or town. Section 15 directs how the business of the company shall be managed, and concludes: 'But no conveyance or mortgage of the real estate of the company or lease thereof for more than one year shall be made unless authorized by a vote of the stockholders at a meeting called for the purpose.' By the statute of 1879, chapter 202, section 1, companies were authorized to be formed 'for the purpose of making and selling gas for lights or for the purpose of generating and furnishing steam or hot water for heating, cooking and mechanical power, in any city or town, or for either or both of said purposes,' under the provisions of the statute of 1870, chapter 224. It is from these acts that sections 11 and 23 of Public Statutes, chapter 106, are derived. Without relying upon the remarks of Chief Justice BIGELOW in Commonwealth *v.* Lowell Gas Light Co., 12 Allen, 75, which are strongly in favor of the view that a gas company is not a *quasi* public corporation, it seems to us very clear that the legislature intended to treat a gas company or a heating company as an ordinary manufacturing corporation and not as a *quasi* public corporation so far as the power to make a mortgage is concerned, and that the peculiar language of the statute of 1870, chapter 224, section 15, and of Public Statutes, chapter 106, section 23, is due to the fact that as a manufacturing corporation it could make a mortgage without special authority."

other corporation to which it was indebted as above stated "a bond conditioned for the payment of ———, and a mortgage to secure the same upon the lands and premises by them owned, situate in the city of Brooklyn," etc. The New York Court of Appeals, CHURCH, Ch. J., delivering the opinion, said: "Regarding this as authority from principal to agent, taken in connection with the act of 1864, I think it sufficient to authorize a mortgage to secure any debt of the character specified in the act of 1864 which the manufacturing corporation owed the plaintiff. It is necessary to specify the amount of the debt or the character of it. It is conceded that if the paper had authorized the payment of any debt owing to the plaintiff, it would, in this respect, have been sufficient. The authority was unlimited as to the amount, and, therefore, it authorized securing any amount which the act authorized to be secured. This, it seems to me, is its legal effect, and it is as effectual as if it had specified the indebtedness or referred to the debt as one owing to the plaintiff. No statute authority was requisite to the giving of the bond. The stockholders expressly authorized a bond to be given, and, as the amount was not restricted, I think, upon recognized principles in analogous cases, that the authority was ample to execute the bond in question. The stockholders themselves would not, in the absence of fraud, be heard to deny this authority. It would not, of course, authorize a bond for a sum not owing or for a debt not authorized to be secured by mortgage, but within this limitation it would authorize a bond for any amount." The contention in part of the appellant here was that not only the particular sum be named, but the date and terms of the mortgage must be specified. The chief justice said upon that: "[Such] a construction * * would practically destroy the value of the provision. The defendant could not have been misled. The consent in this case was ample to put him upon inquiry. If he examined the files, he was informed that the stockholders had authorized a mortgage to secure a bond for an amount limited only by the amount of the debt actually existing of a specified nature, and the mortgage on record informed him of the extent to which the authority had been exercised. He seeks to gain a preference, not by objecting either that the amount of the debt or its nature was not correct and legitimate, nor claiming that he was in any manner deceived or misled, but by criticising the form in

which those interested saw fit to express their assent. Assuming his right to object, we think the defects must be so radical that an intention to consent cannot be inferred."[1] The statute of New York, which required the written assent of stockholders owning two-thirds of its capital stock to be first filed to authorize the execution of a mortgage by a corporation as security for debts incurred, has been held by the Court of Appeals to have been complied with where the requisite consent was given, although not filed before the execution of the mortgage and no rights of other creditors had intervened to make the mortgage valid in this respect as against the company and its stockholders.[2] A resolution at a stockholders' meeting, passed by vote of stockholders owning more than two-thirds of the stock, entered on the minutes and attested by the secretary, has been held to be a ".written assent" within the meaning of the statute of New York requiring the assent of such a proportion of stockholders to the execution of a mortgage by a corporation.[3] A corporation formed under the act of New York for the formation of manufacturing and other kinds of corporations contested the validity of a mortgage upon the real estate of the corporation made to secure the payment of bonds of some of which the defendants were the holders. The validity of the mortgage was impeached upon the ground that "the written assent of the stockholders owning at least two-thirds of the capital stock" was required by the statute. There was a written assent. The corporation's claim as to this was that eighty shares represented in the assent had never been lawfully issued, and that the remaining shares were not two-thirds of the capital. The judge below in effect found that if the eighty shares were excluded there were still represented in the assent two-thirds of the capital stock. The Superior Court

[1] Greenpoint Sugar Co. *v.* Whitin, (1877) 69 N. Y. 328, 334, 335, 336.

[2] Martin *v.* Niagara Falls Paper Manufacturing Co., (1890) 122 N. Y. 165; s. c., 25 N. E. Rep. 303; citing Rochester Savings Bank *v.* Averell, 96 N. Y. 467.

[3] Beebe *v.* Richmond Light, Heat & Power Co., 35 N. Y. Supp. 1. Assent of stockholders to mortgage: Market & Fulton National Bank *v.* Jones, 7 Misc. Rep. 207; s. c., 27 N. Y. Supp. 677; Adams Cotton Mills *v.* Dimmick, 96 Ala. 238. That the statute of New York of 1890, requiring the mutual assent of two-thirds of the stockholders to the execution of a corporate mortgage, is not applicable to a mortgage given in fulfilment of a valid and obligatory contract made upon a full and valuable consideration before the passage of the statute, see Atlantic Trust Co. *v.* Proceeds of the Vigilancia, 68 Fed. Rep. 781.

of New York city in General Term affirmed the finding and judgment.[1] The assent to a mortgage executed in a case by a manufacturing corporation of the state of New York was signed by a certain number of stockholders and by the corporation itself, by its secretary and president, this being done as they intended to represent 940 of the 5,000 total shares which stood in the name of the corporation itself. The New York Court of Appeals held that these shares represented by the company could not be counted to make the amount in value required by the statutes of the state to assent to the execution of a mortgage.[2]

[1] Lyceum *v.* Ellis, (1890) 57 N. Y. Super. Ct. 532; s. c., 8 N. Y. Supp. 867. "In this [finding]," said Sedgwick, Ch. J., in General Term of the Superior Court of New York city, speaking for a majority of the court, "he was correct, under the case of Greenpoint Sugar Co. *v.* Whitin, 69 N. Y. 328. That case decided that 'for the purposes of this act * * * the amount actually issued and owned should be regarded as the amount of the capital stock. The design was to confer this power of assent upon those who represented two-thirds of the actual stock. They represented two-thirds of the pecuniary interest and property of the corporation. The learned counsel for the plaintiff argues that the case cited makes a limitation of the general principle announced by saying in reference to what it held to the amount of the capital stock or the two thousand shares, 'and, for aught that appears, no more was intended to be issued.' The meaning of this, I take to be, that an assent to a mortgage made by two-thirds of the then capital stock, will not be sufficient, if, also, then there is a definite intention of increasing the actual stock by future issuing of shares in a manner that will increase the actual stock. The intention referred to is not a general intention; that is presumed as to all shares not transferred. It would be an attempt to evade the statute, that a mortgage should be made upon the assent of two-thirds of the actual capital, when that was accomplished by the beginning of an arrangement to increase the capital, or even by an intention forthwith to make such an arrangement. That method would be fraudulent as to those who might afterwards become the owners of shares. In the present case the fact is that if there were an intention to issue the shares one hundred and twenty in number, of which the eighty was represented in the assent, the result would be that those one hundred and twenty shares must be considered part of the actual capital, and then the persons to whom the issue was made would be considered the owners of the shares. In such case there was an assent of two-thirds of the capital stock upon the position taken by the plaintiff.'"

[2] Vail *v.* Hamilton, (1881) 85 N. Y. 453, 456, 457. Danforth, J., said: "The persons who became 'a body politic and corporate' under the name of the 'Secor Sewing Machine Company,' were made capable of buying, purchasing, holding and conveying in their corporate name any lands, goods, wares and merchandise necessary to enable the company to carry on the operations named in their certificate of incorporation. But while a certain limited number of the stockholders, to be called trustees, were empowered in that character to manage this property

The Supreme Court of New York in General Term, where it was part of the arrangement under which land was conveyed to an incorporated association that it should give two mortgages to secure future advances for improvements thereon, and the mortgages and the deed were executed and delivered contemporaneously, sustained the finding of a referee that the mortgages were not invalid because of any failure to comply with the requirements of a statute of that state, providing that associations incorporated under it shall, as a condition precedent to the giving of a mortgage to secure a debt contracted by it in the course of its business, have the assent of two-thirds of the owners of the capital stock, holding these mortgages not within the act.[1] In a West Virginia case, a corporation of the state of New York, in an action to foreclose a mortgage upon its mining lands in the former state, the corporation attempted to put in issue the validity of the mortgage, claiming that it was invalid by reason of the assent of stockholders required under the New York statutes not having been given. Even if this were conceded, the Court of Appeals of West Virginia held that the question of whether the proper assent of stockholders had been given could not be raised by the corporation.[1] The validity of a mortgage executed by a corporation in North Carolina was assailed by other creditors, and the Supreme Court of that state made the following rulings: The assent of a majority of stockholders, expressed elsewhere than at a meeting of the stockholders, as where the assent of each is given separately and at different times to a person who goes around to them privately, does not bind the company. An agency to execute a mortgage given in this manner gives no validity to the mortgage. It is not the corporation's act, which can only be authorized in the mode required by law. The use by the company of money raised by such mortgage would not of itself be a ratification. If the company ratify the mortgage, it would not validate it as to other creditors if the mortgage is invalid when registered.[2]

and the stock and concerns of the company, neither in a corporate capacity, nor through its trustees, was it permitted to mortgage the same without first obtaining and filing 'the written assent of the stockholders owning at least two-thirds of the capital stock of such' company. [Citing the laws of the state.] It is noticeable that there is thus called into action the corporation as an artificial entity, the body of the trustees as its agents, and, lastly, the constituent members of the corporation or the several individuals composing it. To each of these a duty is assigned, and, to make valid the transaction now before us, it is plain that something more than corporate action was required. The corporation might become a party to the mortgage, and the trustees direct its officers to execute it; but there must still be the assent of the stockholder. The will of the whole body, expressed by vote or resolution, cannot take its place. The name of the corporation is signed to the assent. This, if it amounts to anything, must be the result of corporate, not individual action. It was signed by its officers, and their act, to bind even the corporation, must have been official; it can have no force as representing an individual. As to nine hundred and forty shares, therefore, there is no other assent to the mortgage in question than that of the corporation. The mortgage itself must be deemed a corporate act, and assent thereto by the same body can give it no additional validity. As to those shares assent has not been given. It follows, also, that as the corporation cannot assent for the stockholders, neither can one stockholder for another; nor can one who assents on the strength of stock standing in his own name, be deemed to represent a proportionate amount of the stock owned by the corporation."

[1] McComb *v.* Barcelona Apartment Assn., (1890) 10 N. Y. Supp. 546; citing Sugar Co. *v.* Whitin, 69 N. Y. 328, 336, 337; Coman *v.* Lakey, 80 N. Y. 345.

[1] Boyce *v.* Montauk Gas Coal Co., (W. Va. 1892) 16 S. E. Rep. 501. The court said: "In the case of Beecher *v.* Rolling Mill Co., 45 Mich. 103; s. c., 7 N. W. Rep. 695, under a statute which forbade a manufacturing company to mortgage its property unless authorized thereto by vote of stockholders holding three-fifths interest, and notified of the object of the meeting called to obtain such vote, and which provides that without notice the proceedings shall not be valid, where notice was given of a meeting to authorize the issue of bonds to the extent of one hundred thousand dollars, secured by mortgage, and the meeting actually authorized an issue to the amount of one hundred and fifty thousand dollars, it was held that, so long as the corporation raised no objection to the proceedings no one else could. Judge Cooley, delivering the opinion of the court, says: 'The statute now under consideration was passed to protect the interests of stockholders in mining companies. It intends that their mining property shall not be conveyed away or mortgaged except by their deliberate action, after they have been notified of a proposal to do so, and have had time to deliberate upon and fully consider it. But the matter does not concern the public at large. No principle of public policy is at stake. No wrong, direct or indirect, is done to any human being, if conveyance is made or mortgage given without the exact notice required, unless it be a wrong to the stockholders themselves; and, as others are not concerned, why should the statute give them the right to raise questions of regularity which the stockholders elect to waive? We are satisfied such was not its purpose.'"

[2] Duke *v.* Markham, (1890) 105 N. C. 131; s. c., 10 S. E. Rep. 1017.

§ 508. Mortgages and trust deeds — rules as to place of execution, authorization, mode of execution, to whom executed, record, etc. — The United States Circuit Court for the eastern district of Louisiana held, in a suit to foreclose a mort-

gage given by a New Jersey corporation upon its property in Louisiana, that it was no defense that at the time of executing the mortgage some of the directors were not residents of New Jersey.[1] Neither was the mortgage invalidated by the fact that the directors went into New Jersey and remained there only a brief period, to hold the meeting at which was passed the resolution authorizing the mortgage.[2] A trust deed to secure bonds will not be held invalid because it may not be in strict accordance in some particulars with the resolution of the corporation's board of directors authorizing it, when, subsequent to its execution, the board of directors have recognized the existence and validity of the mortgage by directing the issuance of the amount of bonds it was given to secure.[3] Certain officers and directors of a private corporation in Nebraska loaned their credit to it by executing notes for the accommodation of the corporation, thus obtaining capital for its operations. They were secured by a mortgage upon the plant. When they brought action to foreclose this mortgage certain alleged stockholders intervened and defended upon various grounds, with a prayer for a dismissal of the petition, and that the mortgages and the record thereof be canceled, and for equitable relief. These interveners, by an amendment of their answer, with the permission of the court, also claimed to be creditors of the corporation for advances made to it, and prayed for a receiver to take charge of its property, convert it into cash, and apply the proceeds to the payment of its general indebtedness, and if anything was left to apply it *pro rata* among the stockholders. There was a finding and a decree of foreclosure in favor of the plaintiffs, and an appeal by the interveners. The first proposition argued before the Supreme Court was that the evidence failed to show authority from the board of directors for the execution of the mortgages, or either

[1] Wheelwright *v.* St. Louis, N. O. & O. Canal Transportation Co., (1893) 56 Fed. Rep. 164. BILLINGS, D. J., said: Whatever force there might have been in this objection in case the state had brought a *quo warranto* against the corporation, there is no force in it in this proceeding. The board was elected by stockholders in the manner pointed out by the charter, and as against a creditor the directors are clearly competent.

[2] Wheelwright *v.* St. Louis, N. O. & O. Canal Transportation Co., (1893) 56 Fed. Rep. 164. As to officers acting outside the state, see Missouri Lead Mine & Smelting Co. *v.* Reinhard, 114 Mo. 218.

[3] First Nat. Bank *v.* Sioux City Terminal R. R. & Warehouse Co., 69 Fed. Rep. 441.

of them. To this argument the court said: "Both mortgages purport to have been executed by the [corporation] and acknowledged in behalf of said [corporation] by F. R. Guthman, president, and E. B. Lewis, secretary, and attested by the seal thereof. The genuineness of the signatures to the mortgage, as well as the official character of the signers, is specifically admitted, but we understand counsel for interveners to contend that authority for the execution of the mortgages must affirmatively appear from the record of the board of directors. To that proposition we cannot give our assent. The signatures of the officers, with the corporate seal attached, is *prima facie* evidence that the mortgages were executed by authority of the company, and the burden of proving want of authority is upon the interveners."[1] Upon the questions raised as to the execution of chattel mortgages of an insolvent Michigan corporation, the United States Circuit Court of Appeals for the sixth circuit held that under the resolution adopted by the directors of the corporation, reciting an agreement by a creditor to advance to the corporation $3,000, and a further sum of $1,000, if required, and authorizing the secretary and treasurer to secure the total indebtedness by chattel mortgage, this creditor, having advanced the $3,000 — the additional $1,000 not being required by the corporation — was entitled to the mortgage. And the further authorization in the resolution of the secretary and treasurer, to secure "any and all other creditors" by subsequent mortgages, did not require a mortgage to secure all other creditors, the word "and," in the opinion of the court, in that connection having the meaning of "or." Neither were the mortgages invalidated by the fact that some of the directors and stockholders who, as such, voted for the resolution authorizing the mortgages, were also guarantors and indorsers upon most of the secured notes.[2] After holding that a heating

[1] Gorder *v.* Plattsmouth Canning Co., (1893) 36 Neb. 548, 551, 552; citing Ang. & Ames Corp. § 217; Boone Corp. § 50; Blackshire *v.* Iowa Homestead Co., 39 Iowa, 624; Whitney *v.* Union Trust Co., 65 N. Y. 577; Davis *v.* Jenney, 1 Met. 221; Williamsburg City Fire Ins. Co. *v.* Frothingham, 122 Mass. 391; Murphy *v.* Welch, 128 Mass. 489; Hamilton *v.* McLaughlin, (Mass.) 12 N. E. Rep. 424; Morris *v.* Keil, 20 Minn. 531; Musser *v.* Johnson, 42 Mo. 74.

[2] Brown *v.* Grand Rapids Parlor Furniture Co., (1893) 58 Fed. Rep. 286, following on this last point, Bank of Montreal *v.* J. E. Potts' Salt & Lumber Co., 90 Mich. 345; s. c., 51 N. W. Rep. 512; citing Hills *v.* Furniture Co., 23 Fed. Rep. 432; County Court *v.* Baltimore & O. R. Co., 35 Fed. Rep. 161, and reviewing many other cases.

company organized under the Public Statutes of Massachusetts (Chap. 106, §§ 11, 23), had authority to make a mortgage to secure bonds issued by it, the Supreme Judicial Court considered the question whether the mortgage was authorized "at a meeting called for the purpose as required by § 23, above referred to." They said: "The notice of the meeting stated the object to be 'to consider the question of an issue of bonds of the company secured by a mortgage of its property.'" There was an objection that the notice did not indicate that final action was to be taken, and, therefore, the action at the meeting did not operate to authorize the execution of the mortgage. The court held that action at the meeting upon the subject of executing this mortgage was properly taken, the notice being sufficiently explicit to amount to a compliance with the statute.[1] The Iowa Supreme Court has held that where the resolution authorizing the execution of a deed of trust conveying the property of a corporation was passed at a meeting of the directors, at which four out of five were shown by the minutes to be present, and the minutes showed that two of them voted for the resolution, and that one of them voted against it, and that it was adopted, but the president, whose vote was not shown by the minutes, signed and approved them, the president will be presumed to have voted for it, and that it

[1] Evans *v.* Boston Heating Co., (1892) 157 Mass. 37. The court said: "The object of a call is undoubtedly to give notice of the business which is to be transacted at the meeting. The notice in this case was issued to members of a business corporation, and it could hardly have been understood by them as calling a meeting simply for the purpose of debate, and we are of opinion that this is not its fair intendment, and that action under it might be taken. At the time of the notice the corporation had a leasehold estate in a parcel of land, with an option to purchase it. We see no reason why this was not 'property' within the meaning of the notice, nor why it was not sufficiently indicated by the notice. After the directors had been authorized at the meeting to purchase the land in which the corporation then had a leasehold estate, and to mortgage 'any or all of the rights, estate, property and franchises' of the corporation, the land was conveyed to the corporation, the property was mortgaged, and the land was paid for out of the proceeds of the mortgage. We do not think that the fact that between the time of the meeting and that of the execution of the mortgage the interest of the corporation in the land changed from an estate for years to a freehold estate made it necessary to call a new meeting or to pass a new vote. The notice of the meeting gave warning that a mortgage of the property of the company was to be considered. The votes passed at the meeting, by fair intendment, contemplated and authorized the doing of what was in fact done."

must be regarded as duly adopted.[1] A number of questions arose in a Massachusetts case as to the powers of the officers of a New Hampshire corporation doing business in the State of Massachusetts, in connection with the execution of a mortgage upon real estate in the latter state. The Supreme Court held, upon the contention that the mortgage made to the savings bank by the corporation was without lawful authority and void, by virtue of the statute of Massachusetts, which provides that no conveyance or mortgage of the real estate of a corporation or "lien thereof for more than one year shall be made, unless authorized by a vote of the stockholders at a meeting called for the purpose," no such vote having been passed authorizing the mortgage in question, that the statute did not refer to foreign corporations.[2] The Iowa

[1] Rollins *v.* Shaver Wagon & Carriage Co., (1890) 80 Iowa, 380; s. c., 45 N. W. Rep. 1037. See as to authority of officers to execute a mortgage, Jesup *v.* City Bank of Racine, 14 Wis. 331; Haven *v.* Adams, 4 Allen, 80; Kennebec & Portland R. R. Co. *v.* Portland & Kennebec R. R. Co., 59 Me. 9; Luse *v.* Isthmus Transit Ry. Co., 6 Or. 125; Miller *v.* Rutland & Washington R. R. Co., 36 Vt. 452; Fitch *v.* Lewiston Steam Mill Co., 80 Me. 34; s. c., 12 Atl. Rep. 732.

[2] Saltmarsh *v.* Spaulding, (1888) 147 Mass. 224; s. c., 17 N. E. Rep. 316. DEVENS, J., speaking for the court, said: "While the general principle undoubtedly is, that the law of the place where real property is situate exclusively governs as to the title of parties therein, the disposition and mode of transfer thereof, and the solemnities attending such transfer, and while we do not doubt that it would be possible to provide by legislation that foreign corporations, permitted to own real property situate in this state, should only transfer the same by the authority of the stockholders, no such provision has been made. Attorney-General *v.* Bay State Mining Co., 99 Mass. 148. While they must comply in their forms of conveyance with those here required, they derive their authority to make them from the rules imposed upon them by the states where they are created." To the further contention that there was no power vested in the board of directors by the laws of New Hampshire which authorized them to make a deed of real estate, the court said: "The by-laws of the corporation vested the management and control of its business and the authority to appoint all necessary agents therefor in the board of directors. The mortgage deed was made in the name of the corporation, and under its seal by the president and treasurer of the corporation, by virtue of an express vote of the directors giving them authority. The General Statutes of New Hampshire of 1878, chapter 147, section 4, clause 3, which are made a part of the case, empowered the corporation to adopt by-laws 'to regulate the number of officers, their powers and duties, the mode of choosing them, and their tenure of office; and any others necessary and suitable to promote the objects of the corporation; and alter and amend the same.' The corporation was one authorized to make contracts necessary and proper for its business, and to purchase, hold and convey real and

Supreme Court has held that a trust deed made by a corporation to secure preferred creditors could not be assailed, as to one of the creditors secured, on the ground that one of the directors who voted for it was her husband and another her brother, and that without their votes it could not have been made.[1] Where a charter of a Pennsylvania corporation provided that the property of the association should be purchased, held, managed and sold by a board of five trustees, a mortgage executed by the president and secretary of the corporation, and not by its trustees, and not sealed with the corporate seal, and there was not to be found on the books of the corporation any resolution authorizing, ratifying, or in any manner recognizing, the making of this mortgage, was held by the Supreme Court of Pennsylvania not to be the act and deed of the corporation, or binding upon it as such.[2] A corporate mortgage has been held valid as against an attack of creditors who were not stockholders, though not authorized by a majority of the stockholders at a "regular general meeting" as required by its charter.[3] No one but a stockholder can take advantage of a failure to advertise a notice of a stockholders' meeting, as required by the Tennessee statute, at which

personal estate necessary for the transaction of its business. Gen. Sts. of N. H. of 1878, chap. 147, §§ 5, 6. The directors, by virtue of the powers implied from their position, had the general control and management of the business, which of necessity involved the raising of money to carry it on. It is found that the money raised by means of the mortgage was expended in the real estate of the mortgagor. In the absence of any prohibitory statute, a sufficient authority is shown on the part of the directors to mortgage the property, and doing so they could adopt the form ordinarily in use where the real estate was situated." Citing Burrill *v.* Nahant Bank, 2 Met. 163, 166; Sargent *v.* Webster, 13 Met. 497; Hendee *v.* Pinkerton, 14 Allen, 381, 387; Despatch Line of Packets *v.* Bellamy Mfg. Co., 12 N. H. 205.

[1] Rollins *v.* Shaver Wagon & Carriage Co., (1890) 80 Iowa, 380; s. c., 45 N. W. Rep. 1037. The court said: "She was not an officer nor stockholder of the company at that time; but, had she been one of its officers, that fact would not have deprived her of the right to enter into competition with other creditors in a race of diligence, availing herself of her superior knowledge and of her position to obtain security for or payment of her debt. Buell *v.* Buckingham, 16 Iowa, 291; Warfield *v.* Canning Co., 72 Iowa, 666; Garrett *v.* Plow Co., 70 Iowa, 697. Much less would it have prevented her relatives on the board from acting in good faith, and without fraudulent intent, to secure or pay her."

[2] McElroy *v.* Nucleus Association, (1890) 131 Pa. St. 393; s. c., 18 Atl. Rep. 1063; 25 W. N. C. 262.

[3] Antietam Paper Co. *v.* Chronicle Pub. Co., (N. C.) 20 S. E. Rep. 366.

a mortgage of a railroad is authorized.[1] A mortgage having been executed under the seal of a corporation, regular on its face, and by the properly constituted officers, is *prima facie* evidence that the corporation authorized its execution, and those objecting to it have the burden of proving that it was executed without such authority.[13] It has been held by the United States Circuit

[1] Central Trust Co. *v.* Condon, 67 Fed. Rep. 84. As to authority to execute mortgages to secure bonds or other obligations, see Adams Cotton Mills *v.* Dimmick, 96 Ala. 238; Brown *v.* Supply Co., 23 Or. 541; Grant *v.* Railroad Co., 13 U. S. App. 1; s. c., 4 C. C. A. 511; Manhattan Hardware Co. *v.* Phalen, (Pa.) 18 Atl. Rep. 428; Wright *v.* Hughes, 119 Ind. 324; s. c., 21 N. E. Rep. 907. When a mortgage is void for non-compliance with the statute in its execution, see Alta Silver Mining Co. *v.* Alta Placer Mining Co., 78 Cal. 629; s. c., 21 Pac. Rep. 373.

[13] Wood *v.* Whelen, 93 Ill. 153. In Saltmarsh *v.* Spaulding, (1888) 147 Mass. 224; s. c., 17 N. E. Rep. 316, as to the execution of mortgages by a corporation, it was said: "The provision that a corporation authorized to hold real estate may convey the same by an agent duly appointed for that purpose (Gen. Sts. of N. H. of 1878, chap. 135, § 2) does not exclude other modes of conveyance; as, for instance, in the name and under the seal of the corporation itself, and by the president and treasurer. Especially would this be so where the latter form is that used where the real estate is situated. Morris *v.* Keil, 20 Minn. 531; Bason *v.* King's Mining Co., 90 N. C. 417. It is said, however, that, even if the directors might make the mortgage, they had no power to delegate this authority, but must exercise it themselves. The directors delegated no discretionary power; they determined upon the mortgage, and made the president and treasurer simply the agents to execute formally that which they themselves had voted to do. In Burrill *v.* Nahant Bank, 2 Met. 163, it was accordingly held that the directors of the bank not only might mortgage its real estate to secure a debt due from the bank, but might delegate such authority to a committee of their own number." There was a further contention that a vote of the directors passed without the state to which their corporation owed its existence was void. Upon this the court said: "The corporation was organized for the purpose of doing business without the limits of New Hampshire. Its works were within this state, and here its contracts were made and its business was conducted. Its by-laws, passed at a meeting of the corporation in New Hampshire, while they provide for the annual meeting of the corporation in that state, and for the choice of officers there, provide also for meetings of the directors for business in this state, for the control of the business and the appointment of the necessary agents here, and for the filling here by the directors temporarily of any vacancies that may have occurred. We do not doubt that this may be done by the corporation. It would certainly be an extraordinary anomaly, if, while by the comity prevailing between the states the corporation was allowed to conduct its business, it could disavow the acts of those whom it has appointed to direct its business here, on the ground that the votes by which they were done were passed here. The case cited, of Miller *v.* Ewer, 27 Me. 509, to sustain the statement in Angell & Ames on

Court of Appeals for the fifth circuit that when an assistant secretary of a railroad company acted as the secretary in fact, transacting the business of the company with the knowledge of the directors, and as such *de facto* secretary attached the seal of the company to mortgages executed by the company on land granted to it by the state of Florida, it was not necessary for the mortgagee, in establishing the validity of the mortgages, to show that he was assistant secretary *de jure*.[1] The statute of Montana, requiring foreign corporations, before doing business in the state, to file, in the office of the recorder of the county wherein it intended to carry on business, a copy of its charter and certain verified statements as to its capital, has been held in the United States Circuit Court for the district of Montana not to prevent a foreign trust company which has not complied therewith from purchasing securities of a railroad company in the state and taking a mortgage upon its property to secure them.[2] There having been an objection to an answer in this case that a trust company holding a mortgage upon railroad securities which had filed a cross bill asking for relief was not entitled to it for failure to record its mortgage as required by the statute of Montana as to the recording of chattel mortgages, the objection was sustained in the federal court, the court holding that in this matter the statute relating to mortgages by railroad companies, providing that the record in the office of the secretary of state of a mortgage by a

American Corporations, § 274, on which the defendants rely, only holds that a corporation established under a charter of the state of Maine could not organize in another state, and that the attempt to do so was void, but recognizes fully that a corporation only organized, and acting within the limits of the state granting the charter, may, by agents duly constituted, act and contract without the limits of the state."

[1] Augusta, Tallahassee & Gulf R. Co. *v.* Kittel, (1892) 52 Fed. Rep. 63.

[2] Gilchrist *v.* Helena, H. S. & S. R. Co., (1891) 47 Fed. Rep. 593. KNOWLES, J., said: "I do not think the purchasing of securities or the accepting of a mortgage upon property from a company in Montana can be considered as doing business in Montana." See Manufacturing Co. *v.* Ferguson, 113 U. S. 727; s. c., 5 Sup. Ct. Rep. 739. The Indiana statute, which declares conveyances in trust to other than *bona fide* residents of the state invalid, has been held not to apply to deeds of trust to a foreign corporation, securing the bonds of a railroad corporation within that state, in Farmers' Loan & Trust Co. *v.* Chicago & Atlantic Ry. Co., 27 Fed. Rep. 146. A mortgage upon railroad property, executed to a foreign corporation as trustee in Illinois to secure payment of bonds payable outside the state has also been held not to be prohibited by the laws of that state or contrary to public policy, in Hervey *v.* Illinois Midland Ry. Co., 28 Fed. Rep. 169.

railroad company, the line of which is wholly or in part in Montana, shall be notice to all parties without further record, was not repealed by implication by the passage of the statute as to chattel mortgages, and its having been complied with, was sufficient record of the mortgage.[1] As a mortgage of railroad rolling stock is a chattel mortgage under Civil Code of California, section 2956, it is void against a subsequent attachment, when not executed and recorded in the manner prescribed, or accompanied by the affidavits of good faith required by section 2957.[2] When a mortgage by a corporation is signed by the president, secretary and two stockholders and duly witnessed, but there is no common seal attached, and the probate recites that it is "acknowledged by the secretary, who also proves the execution by the president and two stockholders," such probate is insufficient and does not authorize registration and is ineffectual to pass title as against creditors.[3]

§ 509. Estoppel of corporation to deny authority of officers to mortgage.— A corporation in the state of Washington had given its notes and executed a mortgage upon its property to secure the payment of these notes. The note and mortgate were executed and delivered by the president and secretary of the corporation without being previously authorized by the board of trustees so to do. Upon the holder of the mortgage proceeding to foreclose his mortgage the corporation defended upon the ground that the note and mortgage were executed by its executive officers without authority. The Supreme Court of that state held that although the note and mortgage may have been executed without authority from its board of trustees, yet the corporation would be estopped from denying the authority of its officers where it appeared that the corporation was aware of the transaction from the first and never objected or sought to repudiate it; that at a regular meeting of its board of trustees the payment of the note and mortgage was considered and discussed, and

[1] Gilchrist *v.* Helena, H. S. & S. R. Co., (1891) 47 Fed. Rep. 593.

[2] Union Loan & Trust Co. *v.* Southern California Motor Road Co., (1892) 51 Fed. Rep. 840. As to recording such mortgages, see Allen *v.* Montgomery R. R. Co., 11 Ala. 437; Bement *v.* Plattsburgh & Montreal R. R. Co., 47 Barb. 104; Coe *v.* Col., Piqua & Ind. R. R. Co., 10 Ohio St. 372; Branch Sons & Co. *v.* Atlantic & Gulf R. R. Co., 3 Woods, 481.

[3] Duke *v.* Markham, (1890) 105 N. C. 131; s. c., 10 S. E. Rep. 1017.

in fact two payments made thereon out of the corporate funds; and that no act of repudiation was undertaken until two years after the execution of the note and mortgage, and after they had passed into the hands of innocent purchasers.[1] In this case it was claimed, further, that if the debt were valid, the mortgage given to secure it was not, on account of an alleged absence of a resolution by the directors empowering the president of the corporation to make the mortgage. Of this it was said, in the opinion rendered by the Supreme Court: "But the mortgage recited such a resolution, and it is not denied that it is contained in the minutes of the corporation. The mortgage is under the corporate seal, signed by the president and attested by the secretary of the [corporation]. The mortgagee knew that the corporation had power to borrow money upon bond and mortgage, and in the utmost good faith advanced his money to the corporation and accepted the mortgage as security for it. Upon its face the mortgage represented that it was duly authorized by the directors, and under the circumstances he was not bound to look beyond it. He had the right to assume as against the company that all matters of internal management had been complied with. The minutes of the corporation were not for his inspection, and, if he had been allowed access to them, would have sustained the recital in the mortgage. No director or stockholder has ever claimed that the mortgage was unauthorized, but, on the contrary, stockholders owning a clear majority of the stock issued by the corporation have recognized its validity in their bill for the appointment of a receiver. It is the receiver appointed upon their bill who is

[1] Seal *v.* Puget Sound Loan & Investment Co., (1892) 5 Wash. St. 422. The Supreme Court of Judicature of Maine, in Fitch *v.* Lewiston Steam Mill Co., 80 Me. 34; s. c., 12 Atl. Rep. 732, held similarly. Referring to the facts in this particular case, it was said: "Here was the express authority of the corporation created and existing by vote duly recorded, authorizing and empowering its treasurer to make, sell, execute and deliver, in the name of the corporation, any and all conveyances of land by deed, bond, or otherwise. This authority was broad enough to embrace the transaction in relation to this mortgage. The treasurer, not only in this case, but on other occasions, had acted in like manner, relying on the authority conferred by this vote. The party who advanced the money and received the mortgage was led to believe that the treasurer was acting under that authority. This is not denied. Consequently, after enjoying the benefit of the loan, and acquiescing in the transaction for more than eight years, it does not lie in the mouth of the defendant corporation to say that the mortgage is inoperative and void. Aurora Agr. & Hort. Society *v.* Paddock, 80 Ill. 263."

now seeking, against their protest, to destroy it. For aught that appears in his affidavit of defense, every director and stockholder of the company knew of the loan and mortgage and ratified both by acquiescence. As neither the corporation, its stockholders, nor its creditors can now allege a want of authority to make the loan and mortgage, the receiver cannot do so for them."[1]

§ 510. Effect of laches of corporation in repudiating a mortgage.— Where the president of a company chartered for the purpose of constructing a railroad, under authorization of the board of directors, mortgages the company's land granted to it by a state, and the money, which is loaned in good faith, is used by the officers of the company for company purposes, and the validity of the transaction is recognized by payment of interest, and the transaction being brought to the notice of the directors, both actually and by its being recorded, and there being no repudiation of the mortgage or denial of the authority of the president in the premises, a subsequent resolution by part of the directors, made long afterwards, disaffirming and annulling the president's authority, will not invalidate the transaction or prevent a foreclosure, as by not promptly disaffirming the transaction the company would tacitly ratify the act of the president.[2]

§ 511. What are reasonable provisions in a mortgage.— A trustee of a railroad mortgage brought his action for foreclosure. The holder of bonds secured by several prior mortgages intervened in the suit and asked the foreclosure of these prior mortgages in this action. There were demurrers by various trust companies, trustees in different mortgages, to his complaint in intervention that it did not show a ground for intervention, or state facts sufficient to constitute a cause of action. The inter-

[1] Manhattan Hardware Co. *v.* Phalen, (1889) 128 Pa. St. 110, 118, 119. See, for a ruling upon a similar mortgage by this manufacturing corporation, Manhattan Hardware Co. *v.* Roland, (1889) 128 Pa. St. 119. As to estoppel of the corporation in such a case, see Brooke *v.* Railroad Co., 108 Pa. St. 529; Chestnut Hill, etc., Co. *v.* Ratter, 4 S. & R. 6; Bank of Kentucky *v.* Schuylkill Bank, 1 Pars. 251; Hackensack Water Co. *v.* De Kay, 36 N. J. Eq. 548; Willis *v.* Phila., etc., R. Co., 6 W. N. C. 461; Oil Creek, etc., R. Co. *v.* Penna. Trans. Co., 83 Pa. St 160; Wright *v.* Pipe Line Co., 101 Pa. St. 204; Penn. N. Gas Co. *v.* Cook, 123 Pa. St. 170.

[2] Augusta, Tallahassee & Gulf R. Co. *v.* Kittel, (1892) 52 Fed. Rep. 63.

vener claimed that the provisions of the mortgage were void in so far as they attempted to deprive the holder of any of the bonds which may have become due by default in payment of the interest coupons or the holders of any of the past due coupons from enforcing the remedy whereby he might have his lien established upon the mortgaged property without the requisition of the holders of not less than twenty-five *per centum* of the said bonds then outstanding; that the provisions were in fact an attempt to oust the jurisdiction of any court to entertain a complaint by, or give relief to, the holders of less than twenty-five *per centum* of the outstanding bonds. The Supreme Court of Minnesota, upon the question raised by this contention, held that such provisions were reasonable and valid.[1]

[1] Seibert *v.* Minneapolis & St. Louis Ry. Co. (Griggs, Intervener), (1893) 52 Minn. 148; s. c., 53 N. W. Rep. 1134. It was said by the court: "We are unable to see why the bondholders, subject to reasonable limitations, may not be bound by stipulations in the mortgage of this character, waiving a default, and providing, subject to the conditions named, for the foreclosure by the trustees exclusively. The interests of the bondholders as a class and the nature of the security are to be considered. They are agreements which the bondholders are at liberty to make, and there is nothing illegal or contrary to public policy in them. Chicago & V. R. Co. *v.* Fosdick, 106 U. S. 47, 77; s. c., 1 Sup. Ct. Rep. 10. Each bondholder enters into contract relations with each and all of his co-bondholders. His right to appropriate the security in satisfaction of his bond in such lawful manner as he may choose is modified not only by the express provisions of the mortgage, but by the peculiar nature of the security. Gates *v.* Railroad Co., 53 Conn. 346; s. c., 5 Atl. Rep. 695; Shaw *v.* Railroad Co., 100 U. S. 605, 612; Canada Southern R. Co. *v.* Gebhard, 109 U. S. 534–537; s. c., 3 Sup. Ct. Rep. 363; Guilford *v.* Minneapolis, S. Ste. M. & A. Ry. Co,, 48 Minn. 560; s. c., 51 N. W. Rep. 658. The legislature would have had an undoubted right to have incorporated in the enabling statute authorizing the execution of the mortgage and the issuance of the bonds secured thereby, a provision requiring the mortgage to contain similar stipulations. Howell *v.* Western Railroad Co., 94 U. S. 463–466. It is clear then that it would be competent for the bondholders themselves to agree to them. They are to be treated as *stricti juris*, but, nevertheless, are to be reasonably construed in view of the nature of the mortgage, which is the common security for all the bondholders, and the purposes to be subserved in making them. There is no doubt that the parties could lawfully provide in the same instrument for a reasonable extension of the time for the commencement of foreclosure proceedings, to be determined at the option of a majority of the bondholders. * * * Why may not the mortgage in the common interest stipulate the conditions under which this right may be exercised by the bondholders, and, in order to avoid the risk of rash or arbitrary proceedings, which might result in great injury to the security, provide that no such proceedings should be instituted by an individual bondholder except upon the refusal of the trustee to obey the requisition of a reasonable number of bondholders. It is not the intention or effect of such conditions or stipulations to divest the bondholders of their right to judicial remedies, or to oust the courts of their jurisdiction; it is merely the imposition of certain conditions upon themselves in respect to the exercise of that right." Provisions in a mortgage which do not make it void: Vincent *v.* Snoqualmie Mill Co., 7 Wash. 566; s. c., 35 Pac. Rep. 396. Mortgages given without authority: Ohio Val. Nat. Bank *v.* Walton Architectural Iron Co., 30 Wkly. Law Bull. 382; Currie *v.* Bowman, (Or.) 35 Pac. Rep. 848; Wright *v.* First National Bank, (N. J. Eq.) 28 Atl. Rep. 719.

§ 512. Chattel mortgages of corporations.— It was claimed before the United States Circuit Court of Appeals for the sixth circuit that the chattel mortgages executed by the insolvent corporation, to set aside which this bill in equity was originally brought, were violative of certain statutes of the state of Michigan, the domicile of the corporation. The court held that these chattel mortgages executed by the insolvent corporation to secure a portion of its debts were not common-law assignments with preferences, as between creditors, within 2 Howell's Statutes of Michigan, section 8739, declaring such assignments void.[1] Neither was a chattel mortgage an assignment within the statute, although, in view of the impossibility that the corporation can ever redeem, the effect of the mortgage necessarily is to transfer the property to the trustee named in the mortgage, who thereunder may sell and distribute the proceeds in the same manner as an assignee under such an assignment, as the right of redemption by the corporation or attaching creditors would, nevertheless, exist.[2] The defeasance clause in these mortgages, providing that, if the debts be paid at maturity, the mortgage and the notes secured thereby shall be void, and containing an agreement to pay the same accordingly, was held not to be rendered nugatory by the fact that one of the notes secured was due when the mortgage was made, and that it should rather be construed to require a demand for payment of the note subsequent to the giving of the mortgage, and a refusal to pay before the mortgage would become

[1] Brown *v.* Grand Rapids Parlor Furniture Co., (1893) 58 Fed. Rep. 286, following Sheldon *v.* Mann, 85 Mich. 265; s. c., 48 N. W. Rep. 573; Warner *v.* Littlefield, 89 Mich. 329; s. c., 50 N. W. Rep. 721; Bank of Montreal *v.* J. E. Potts Salt & Lumber Co., 90 Mich. 345; s. c., 51 N. W. Rep. 512.

[2] Brown *v.* Grand Rapids Parlor Furniture Co., (1893) 58 Fed. Rep. 286; Warner *v.* Littlefield, 89 Mich. 329; s. c., 50 N. W. Rep. 721, distinguished.

absolute.[1] In one of the special courts of the city of New York, a complaint of the purchasers of the personal property of a printing company at a sale, with notice of certain chattel mortgages, seeking equitable relief against the holders of these mortgages, that the latter be declared to be void, and for an injunction, was dismissed. The court in General Term affirmed the dismissal of the suit. In the opinion rendered, it is stated that "the plaintiff claimed in its complaint that the chattel mortgages were invalid because the consent of the corporation had not been obtained for the execution thereof. The defendants contend (1) that as the plaintiff represented the purchasers of these chattels, who had notice of the execution of the mortgages before the sales, it is estopped from taking advantage of such a defect, if it existed; (2) that, in fact, the written consent of the corporation to the execution of the mortgages had been obtained and was duly filed. The plaintiff next contends that, as to one of the printing presses, it had been substituted, after the first mortgage was executed, in place of another printing press, and that the consent of the corporation to the mortgage did not apply to the substituted mortgage." The court in General Term held that a purchaser of property of a corporation at execution sale under judgments against it, who had notice of a prior mortgage on the property, could not take advantage of the alleged want of consent to the mortgage by the corporation, as required under the laws of New York. The court concluded its opinion in these words: "But even if it were conceded that the assent of the corporation should have been obtained to the execution of these mortgages, such assent was in fact obtained. The assent of the corporation, as set forth in writing and filed, was an assent 'that the real and personal property of the Star Printing Company may be mortgaged.' This language was broad enough to warrant the canceling of the mortgage on some of the chattels of the company, with the consent of all parties to the mortgage, and the substitution of another mortgage on other chattels of the company. This assent was not

[1] Brown *v.* Grand Rapids Parlor Furniture Co., (1893) 58 Fed. Rep. 286. As to chattel mortgages by corporations, see Cooper *v.* Corbin, 105 Ill. 224; Hoyle *v.* Plattsburgh & Montreal R. R. Co., 54 N. Y. 315; Nichols *v.* Mase, 94 N. Y. 160; Williamson *v.* New Jersey Southern R. R. Co., 29 N. J. Eq. 311; Bement *v.* Plattsburgh & Montreal R. R. Co., 47 Barb. 104; Kelly *v.* Boylan, 32 N. J. Eq. 581; Stevens *v.* Buffalo & New York City R. R. Co., 31 Barb. 590.

of itself a mortgage, but only a permission to mortgage, and authorized the substituted mortgage in question. It should be borne in mind that the objection [object?] of the legislature in requiring such assent was the protection of stockholders against improvidence, collusion or unwise acts of the trustees, the governing body of the corporation, in incumbering the corporate property. Bank *v.* Averell, 96 N. Y. 473. There is no reason to believe that it was any part of the intention of the legislature to supply purchasers of corporate property with means of defeating the just claims of *bona fide* creditors of a corporation, when the existence of such claims, and of the liens depending thereon, were well known to the purchaser, and the justice and validity of such claims were unimpeached."[1]

§ 513. Deeds of trust and mortgages securing directors — when properly given.— The contention here was that the deed of trust executed by this railroad company upon certain lands belonging to it was void because of its execution to secure debts due to certain of its directors, also large holders of its stock and mortgage bonds. The court held, however, that the inducement of the directors being to protect and give value to their own large interests as creditors and stockholders, but all other creditors and stockholders being equally protected thereby, the advances made in good faith by them, and used for legitimate corporate purposes, constituted a valid debt, enforceable by suit, and the deed of trust thereafter executed by the direction of the stockholders and board of directors to secure it was as valid as if given to any other creditor.[2] It was further held that, treating the directors as trus-

[1] Star Printing Co. *v.* Andrews, (1890) 9 N. Y. Supp. 731, 732.

[2] Gould *v.* Little Rock, M. R. & T. Ry. Co., (1892) 52 Fed. Rep. 680. CALDWELL, Circuit Judge, in support of the rule declared in the text, said: "Where a corporation is legally liable to pay a debt it may undoubtedly give security for its payment. The use of its property to pay or secure a *bona fide* debt is not an unlawful use or diversion of its property, no matter what official relation the creditor sustains to the corporation. The corporation is under the same obligation to pay a *bona fide* debt due to one of its directors and stockholders that it is to pay a debt due to a stranger, and a security given for a debt due to a director and stockholder is as valid as a security given to pay other creditors. The doctrine established by the best-considered cases and by the decisions of the Supreme Court of the United States is that the mere fact that creditors of a corporation are directors and stockholders does not prevent their taking security to themselves as individuals to secure a *bona fide* loan of money previously made to such corporation and

tees, the payment of the debt was an essential prerequisite to the avoidance of the deed of trust given to secure it, whether the debt was a present or precedent one.[1] In a chancery case in New Jersey it appeared that there were a number of mortgages

used by it in conducting its legitimate corporate business. Among the states maintaining this doctrine may be mentioned Vermont, Massachusetts, Connecticut, New York, New Jersey, Pennsylvania, Virginia, Illinois, Minnesota and Iowa. The rule is thus stated in a recent case by the Supreme Court of Iowa: 'We understand that he [a director] may become a creditor of the corporation, may advance it money or sell it property, and obligations of the corporation executed therefor may be enforced by him. In this regard he occupies no different position from that of any other creditor, and if the debt he holds was contracted in good faith and there is an absence of fraud on his part he may take security or payment, though the corporation be insolvent, and he may thereby acquire priority in the payment of his claim.' Garrett *v.* Plow Co., 70 Iowa, 697; s. c., 29 N. W. Rep. 395. The previous cases in that court to the same effect are: Buell *v.* Buckingham, 16 Iowa, 284; Bank *v.* Wasson, 48 Iowa, 336; Hallam *v.* Hotel Co., 56 Iowa, 178; s. c., 9 N. W. Rep. 111. In discussing the question the Supreme Court of Connecticut say: 'These creditors had a perfect right to receive pay in money or goods, and the fact that they were stockholders and directors did not modify or abridge that right so long as there was no actual fraudulent intent. The fact, if it be a fact, that it operated to prefer these creditors, is not sufficient at common law to stamp it as fraudulent, for the common law favored the vigilant and a creditor might rightfully obtain a preference.' Smith *v.* Skeary, 47 Conn. 47. And to the same effect see Duncomb *v.* Railroad Co., 84 N. Y. 190; 88 N. Y. 1; Harts *v.* Brown, 77 Ill. 226; Reichwald *v.* Hotel Co., 106 Ill. 439; Stratton *v.* Allen, 16 N. J. Eq. 229; Wilkinson *v.* Bauerle, 41 N. J. Eq. 635; s. c., 7 Atl. Rep. 514; Bank *v.* Whittle, 78 Va. 737; Ashhurst's Appeal, 60 Penn. St. 314; Whitwell *v.* Warner, 20 Vt. 425; Gordon *v.* Preston, 1 Watts, 386; Sargent *v.* Webster, 13 Met. 497; Kitchen *v.* Railway Co., 69 Mo. 224; Oil Co. *v.* Marbury, 91 U. S. 587. An exhaustive and luminous discussion of this question is found in the opinion of the Supreme Court of Minnesota, delivered by Judge MITCHELL, in the case of Hospes *v.* Car Co., (Minn.) 50 N. W. Rep. 1117. The reasoning of the learned judge who delivered the opinion of the court in that case makes it extremely clear that an insolvent corporation may prefer its creditors, whether they be officers of the corporation or strangers, and that there is no foundation for the doctrine that the insolvency of a corporation has the effect to convert its assets into a trust fund in the technical sense of that term, and its officers into mere trustees charged with the duty of distributing its assets ratably among its creditors. The question has been before the Supreme Court of the United States in several cases. In the case of Hotel Co. *v.* Wade, 97 U. S. 13, the court said: 'His [circuit judge's] finding is that the bonds and mortgages were not void upon the ground that the lenders of the money were also the directors of the company; that the terms of the

[1] Gould *v.* Little Rock, M. R. & T. Ry. Co., (1892) 52 Fed. Rep. 680, 686. See Duncomb *v.* Railroad Co., 84 N. Y. 190; 88 N. Y. 1. When directors

executed by a corporation to the directors of the corporation upon the eve of application for a receiver of the corporation as insolvent. The corporation was limited by its charter in its authority to mortgage to a limited amount. At the time these mortgages were executed it had about exhausted its power to raise money by mortgage under its charter. There was a contention that as a consequence these mortgages were *ultra vires*, and since, not for cash loaned, but as security for previous advancements, or against the indorsements of these directors, they were void as to general creditors and could not be enforced in equity. It was also insisted upon the part of the receiver of the insolvent corporation that the mortgages executed by the corporation to its directors and others were illegal and void as to creditors, because conceived in fraud and for the purpose of cheating, delaying and hindering the creditors. Vice-Chancellor BIRD held that, under the Corporation Act of the state of New Jersey, as revised, the directors of a corporation may execute to themselves mortgages to secure the actual or contingent liability of the corporation to themselves, even though it be done in contemplation of imme-

contract were sanctioned by the stockholders, and that the money loaned was needed to complete the building, and that it was applied to effect the purpose for which it was borrowed. * * * Examined in the light of the circumstances attending the transaction, as the case should be, the court is of the opinion that the finding fails to support the proposition that the bonds and mortgage were invalid because the directors became the holders of the bonds and advanced the money. Transactions of the kind have often occurred, and it has never been held that the arrangement was invalid where it appeared that the stockholders were properly consulted and sanctioned what was done either by their votes or silence.' In the case of Richardson's Exr. *v.* Green, 133 U. S. 30, 43; s. c., 10 Sup. Ct. Rep. 280, the court said: 'Undoubtedly, his relation as a director and officer or as a stockholder of the company does not preclude him from entering into contracts with it, making loans to it and taking its bonds as collateral security; but courts of equity regard such personal transactions of a party in either of the speositions, not perhaps with distrust, but with a large measure of watchful care, and, unless satisfied by proof that the transaction was entered into in good faith, with a view to the benefit of the company as well as of its creditors, and not solely with a view to his own benefit, they will refuse to lend their aid to its enforcement.'"

may execute mortgages to themselves: Whittaker *v.* Amwell Nat. Bank, (N. J. Eq.) 29 Atl. Rep. 203; Brown *v.* Grand Rapids Parlor Furniture Co., 58 Fed. Rep. 286; s. c., 7 C. C. A. 225. Execution of mortgage notwithstanding pending insolvency: Sabin *v.* Columbia River Lumber & Fuel Co., (Or.) 34 Pac. Rep. 692.

diate application for the appointment of a receiver, and the lien secured by such mortgagees would be valid and prior to the liens of general creditors, which was contrary to the statute as it existed prior to the revision.[1] The mortgage of the plant of a corporation which was in course of foreclosure in favor of certain officers and directors of the corporation, to whom it was given as a security or indemnity against loss by the loaning of their credit to the corporation, was claimed before the Supreme Court of Nebraska to be void by reason of the fact that the plaintiffs were directors of the corporation at the time the indebtedness was incurred and when the mortgages were executed. The court held the mortgage to be valid and enforceable.[2] In case a corporation, while

[1] Whittaker *v.* Amwell Nat. Bank, (N. J. Eq. 1894) 29 Atl. Rep. 203; citing in support of the rule for construction of the statute adopted, Bowyer *v.* Camden, 50 N. J. Law, 87; s. c., 11 Atl. Rep. 137; Hoetzel *v.* East Orange, 50 N. J. Law, 354; s. c., 12 Atl. Rep. 911; Haynes *v.* Cape May, 50 N. J. Law, 58; s. c., 13 Atl. Rep. 231; Bank *v.* Bridges, 30 N. J. Law, 112; citing as to the validity of the mortgages to directors, Wilkinson *v.* Bauerle, 41 N. J. Eq. 635; s. c., 7 Atl. Rep. 514; Bergen *v.* Fishing Co., 42 N. J. Eq. 397; s. c., 8 Atl. Rep. 523. See Boehme *v.* Rall, (N. J. Eq.) 26 Atl. Rep. 832.

[2] Gorder *v.* Plattsmouth Canning Co., (1893) 36 Neb. 555. The court said: "It should be observed in this connection that two of the plaintiffs * * * were acting as president and secretary respectively, and as such executed the mortgages in behalf of the company. There is no claim made of fraud against the plaintiffs. In fact their conduct throughout proves that they were actuated by no motives but to promote the success of the company and the interest of the stockholders. It is not disputed that the business of the company was conducted from the beginning with money raised by these and other directors upon their personal obligations. And, from the facts disclosed by the record, the inference is irresistible that said money was advanced, and that the mortgages to the plaintiffs were executed, with the knowledge and approval of the stockholders, including the interveners [who were opposing the foreclosure].' After instancing various things appearing in the record to justify such inference, the court further on said as to the one intervener who positively denied knowledge of the mortgages, "We think, in view of the undisputed facts in the case, he should not now be heard to question this legality. He, in common with other stockholders, must have known from the amount of the company's business, that it was obtaining large sums of money from some source and beyond its power to secure except by mortgaging the canning factory and fixtures. It is also in evidence, and not seriously questioned, that at each annual meeting of the stockholders a statement of the assets and liabilities of the company was exhibited and the books examined. When we take into consideration also the fact that the validity of the mortgages was first called in question by the interveners' answer, * * * it is evident that the claim of the latter that the execution thereof was without their consent is not entitled to serious consideration."

still a going concern, is insolvent, a mortgage on its property, executed to secure directors, who are liable as indorsers for it to a large amount, is valid as to general creditors, and that though the mortgage may be procured by the directors without any actual fraudulent intent.[1] The Supreme Court of Iowa has held that a trust deed made by an insolvent corporation, and conveying nearly all its property, was not void on the ground that it was given to secure only a portion of its creditors.[2]

§ 514. The validity of mortgages as affected by restrictions, constitutional, statutory or in charter, upon indebtedness to be incurred.— The Supreme Court of Pennsylvania having sustained the power of this railroad company, under the charter of 1837 and the subsequent act of the legislature of 1853, then considered an objection to the validity of this mortgage, which was that there was in issuing these bonds and executing this mortgage to secure them, on the part of the railroad company, an increase of indebtedness without compliance with the provisions of the Constitution of 1874, to the following effect: "No corporation shall issue stock or bonds, except for money, labor done, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased, except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock first obtained, at a meeting to be held after sixty days' notice, given in pursuance of law," and the acts passed subsequently to carry this constitutional provision into effect, prescribing the mode of proceeding, etc., in such cases of contemplated increase of indebtedness. The court held that the mortgage was not invalid as in conflict with this constitutional provision and statute.[3] It was contended in an

[1] Howe, Brown & Co. *v.* Sanford Fork & Tool Co., (1890) 44 Fed. Rep. 231. The court cited in support of this ruling, Lippincott *v.* Carriage Co., 25 Fed. Rep. 577, 586; White, etc., Mfg. Co. *v.* Pettes Importing Co., 30 Fed. Rep. 864; Adams *v.* Milling Co., 35 Fed. Rep. 433; Beach *v.* Miller, (Ill.) 22 N. E. Rep. 464; Haywood *v.* Lumber Co., 64 Wis. 639; s. c., 26 N. W. Rep. 184; Olney *v.* Land Co., 16 R. I. 597; s. c., 18 Atl. Rep. 181; Rouse *v.* Bank, (Ohio) 22 N. E. Rep. 293; Hope *v.* Salt Co., 25 W. Va. 789; Gillet *v.* Moody, 3 N. Y. 479; Purifier Co. *v.* McGroarty, 136 U. S. 241; s. c., 10 Sup. Ct. Rep. 1017.

[2] Rollins *v.* Shaver Wagon & Carriage Co., (1890) 80 Iowa, 380; s. c., 45 N. W. Rep. 1037; citing as authority Southern White Lead Co. *v.* Haas, 73 Iowa, 404.

[3] Gloninger *v.* Pittsburgh & Connellsville R. R. Co., (1890) 139 Pa. St.

earlier Pennsylvania case that the execution of a mortgage by the corporation, party to the suit, was in violation of the same constitutional provision. In the opinion rendered by McCollum, J., for the Supreme Court, holding the instrument to be a valid one, it was said: "It was given to secure a debt incurred by the company in the improvement of its property, and it was clearly within the power of the corporation to create the debt and to execute the mortgage. It could hold, purchase and transfer such real and personal property as its purposes required, not exceeding the amount limited by its charter or by law, borrow money on bond and mortgage, and secure its indebtedness by them. Act of April 29, 1874, P. L. 73. But it is objected that the debt was not authorized by a previous meeting and consent of stockholders, as directed by § 7, article 21 of the Constitution, and the act of April 18, 1874, P. L. 61. This objection assumes that the debt secured by the mortgage was an increase of indebtedness within

13; s. c., 21 Atl. Rep. 211; 27 W. N. C. 497. As to this contention, the Supreme Court of Pennsylvania said: "We have seen that the right of the company to mortgage its property was complete, absolute, and without any conditions or limitations as to the manner of its exercise. There was nothing, either in its charter or its supplemental acts, or in any general legislation prior to the Constitution of 1874, which imposed any restrictions or formalities upon it, in the exercise of its right to increase its indebtedness or to make mortgages upon its property. Neither the act of 1855 nor the amendment of 1857, which gave power to the legislature to alter, revoke or annul charters of the corporation when they were injurious to the citizens of the Commonwealth, had any specific effect upon this particular chartered right of this company." The court then reviewed several cases in that state, including Ahl *v.* Rhoads, 84 Pa. St. 319, and Lewis *v.* Jeffries, 86 Pa. St. 340, in both of which mortgages executed by banks, without conformity to the requirements of the same constitutional provision and statutes, were upheld by this court. They said: "In view of the provisions of the Constitution, that 'The general assembly shall not remit the forfeiture of any corporation now existing, or alter or amend the same, or pass any general or special law for the benefit of such corporation, except upon the condition that such corporation shall thereafter hold its charter subject to the provisions of this Constitution,' and of the schedule that 'All laws in force in this commonwealth at the time of the adoption of this Constitution, not inconsistent therewith, and all rights, actions, prosecutions and contracts, shall continue as if this Constitution had not been adopted;' and in view of the repeated decisions of this court, that neither the Constitution of 1874, nor the legislation to carry it into effect, had any application to existing charters, it is our plain duty to decide, as we now do, that the [article of the Constitution invoked here] is not applicable to [this railroad company], so as to affect its rights and privileges under its charter."

the intendment of the Constitution. It is consonant to reason and settled by authority that the debts incurred by a corporation in the conduct of its ordinary business, are not affected by the constitutional provision, or by the act of assembly referred to."[1] In an action by certain officers and directors, who had loaned their credit to a corporation, to foreclose the mortgages given for their indemnity against loss upon the plant of the company, it was claimed by interveners, other stockholders, that the mortgages were void for the reason that they were in excess of the amount of indebtedness authorized by the articles of incorporation of the company. The Supreme Court of Nebraska sustained the validity of the mortgages over this objection.[2]

§ 515. A mortgage of corporation property to pay purchase-money debts.—The president, secretary and treasurer of a Pennsylvania manufacturing corporation, as the latter was

[1] Manhattan Hardware Co. *v.* Phalen, (1889) 128 Pa. St. 110.

[2] Gorder *v.* Plattsmouth Canning Co., (1893) 36 Neb. 548. The court said: "It is provided by article 4 that 'The highest amount of indebtedness to which the corporation shall at any time subject itself shall not exceed one-half of the amount of its capital stock issued.' It appears from the bill of exceptions that five thousand dollars of the indebtednsss represented by the mortgages was incurred on the 18th day of August, 1885, on which day the plaintiffs executed their joint note to the [national bank] for the accommodation of the company, the note of like amount, described in the mortgages, being a renewal thereof. At that time the amount of stock issued does not appear, although it is alleged in the answer that the capital stock in February, 1885, was eighteen thousand dollars, nor is the amount of the company's indebtedness apparent from the record. It appears, also, from the minutes of a meeting of stockholders, held January 4, 1886, that 148½ shares of stock were represented thereat, from which it is evident that the stock at that date amounted to at least fourteen thousand eight hundred and fifty dollars. The date when the additional indebtedness of forty-five hundred dollars was incurred does not appear, but the note for said amount is in renewal of an accommodation note executed by plaintiffs for the benefit of the company, long prior to the execution of the mortgages. The presumption is in favor of the validity of the contract in question. It is not, upon its face, necessarily outside the scope of the corporate power of the defendant's company. The recognized rule is that the contracts of a corporation not contrary to the express provisions of its charter, are presumed to be within its powers, and the burden is upon one seeking to invalidate them to prove the facts which render them *ultra vires*. Ohio & M. R. Co. *v.* McCarthy, 96 U. S. 267; Curtis *v.* Gokey, 68 N. Y. 300; Elkins *v.* Camden & Atlantic R. Co., 36 N. J. Eq. 241; Wood Law of Railroads, 526; Boone Corp. 43. This case is clearly within the rule recognized in the authorities cited."

about being pressed for the balance of purchase money for real estate purchased by it for its business, borrowed from a third party the money and executed a mortgage in the name of the corporation to secure it. It appeared in the case that these officers of the company had issued to themselves shares of the stock of the corporation and gave their notes for the money secured by these shares as collateral, but the money was applied to the payment of this purchase-money debt of the corporation. The validity of the mortgage was assailed in a bill in equity of certain shareholders, alleging conspiracy to defraud, and charging that the mortgage was executed to secure a private loan to these officers as individuals and also that the mortgage was executed in violation of the provisions of the Constitution of the state as to increase of indebtedness on the part of the corporation. The validity of the mortgage was upheld by the Supreme Court of the state, they holding that the corporation having executed and delivered the mortgage, the money raised therein being admittedly applied to discharge a purchase-money indebtedness on the mortgaged property, the mortgagee receiving, moreover, certain shares of stock of the company with the note of its officers as additional security for the loan, and, as the mortgage did not increase the indebtedness of the corporation, it was not invalid because in violation of the constitutional provision prohibiting such increase without the consent of the shareholders, and, in the absence of fraud, the mortgagee had a right to all the security the company or its officers were willing to give him.[1]

[1] Powell *v.* Blair, (1890) 133 Pa. St. 550; s. c., 19 Atl. Rep. 559, affirming the decree below. In the opinion which was rendered by SCHUYLER, P. J., in the court below, confirming the master's report, upon the last point made it was said: "In Ahl *v.* Rhoads, 84 Pa. St. 319, it is held that where a bank, without the consent of its shareholders, executes a mortgage upon its property to secure the debt of a creditor, the execution of such a mortgage is not an increase of indebtedness within the meaning of the Constitution, which prohibits any increase of indebtedness by a corporation without the consent of a majority of its stockholders given at a meeting called for that purpose. The ground of that decision is that the mortgage was given as 'security for indebtedness that had already legitimately accrued,' and that, therefore, 'there was nothing in the transaction that could be properly described as the creation or increase of a debt.' We cannot see wherein Ahl *v.* Rhoads differs in principle from the case in hand. True, in the former case the mortgage was given immediately to the creditor, but the effect in both cases was the same, the securing of an existing debt."

§ 516. Illustration of an equitable mortgage.—As to who might resist the payment of this fraudulent judgment, it appeared that two railroads, owned by a Tennessee company and a Georgia company, were constructed to form one line and as a common enterprise, the controlling interest in the stock of each being held by the same parties. The Tennessee company agreed with the contractor who built its road to pay him in mortgage bonds at a fixed rate per mile. The bonds actually delivered to and sold by him were, however, issued by the Georgia company, but the Tennessee company gave a mortgage on its road to secure them. The Court of Appeals held that the persons acquiring these bonds had an equitable mortgage on the road of the Tennessee company, such as would entitle them to contest the fraudulent judgment which gave to sub-contractors fictitious liens on the road. As to the right of parties to raise objections to this equitable mortgage, it was held that the sub-contractors could not object to the mortgage on the ground that it was given by the railroad company when insolvent, and was, therefore, void under the Tennessee law. Their claim, if they had any at all against the company, being a lien prior to the mortgage, and, if they had no claim against the company, but only against the principal contractor, then they had no interest in any disposition the company might make of its property. Neither could a general creditor, whose claim came into existence subsequent to the execution of the mortgage, object to it on the ground of an unlawful preference. There was an objection to this mortgage that there was no power in the company to execute it by reason of the provisions of the Tennessee statute which provides that no railroad company shall have power to execute any mortgage or other lien which shall be valid as against judgments for work and labor done or timbers furnished, etc. The Court of Appeals held that this statute applied only when the labor and materials were furnished in such manner that the railroad company would be liable to pay the contractor or materialman for them, and not when they were furnished to a principal contractor in his individual capacity without establishing a lien in the manner prescribed by the later statute relating to railroads contracting liens; and, further, if, in the latter case judgments were fraudulently obtained against the company, the statute would not prevent a court of equity disregarding them.[1]

[1] Central Trust Co. of New York *v.* Bridges, (1893) 57 Fed. Rep. 753.

§ 517. Mortgage of a consolidated railroad company — estoppel to claim its invalidity on the ground that the consolidation was not legally perfected.— Certain local railroad companies in the state of South Carolina, which had been aided by counties of that state subscribing to their capital stock, looking to securing the greatest benefits to the separate companies and accomplishing the purposes which led counties through which they passed to aid in the construction of the respective roads under the laws of South Carolina, were consolidated under a general corporate name. This consolidated organization executed a mortgage to a trust company to secure bonds which it issued, the latter being used principally for taking up the divisional bonds issued by the separate companies and for use in part in completion and perfection of the roads of the system. The trustee brought action to foreclose this mortgage in the federal court. The suit was resisted by a cross-bill filed by several of these counties which held stock in the separate roads and afterwards in that of the consolidated mortgage. It was contended that the mortgage was an invalid one. One of the questions raised was as to the consolidation. From the statement of the court, it appeared that the agreement entered into was in compliance with the general statute of South Carolina upon the subject of consolidation of roads, and was executed by each board of directors and submitted to the stockholders of the several companies. The minutes of the action of three of the companies confirming the agreement were in evidence, but the minutes of the other company had been lost. The old stock was surrendered and the new certificates accepted. The new company took full charge and control of all the roads embraced in the agreement, without question or exception, and for years exercised such control, with immense advantage to the different roads from the consolidation. The court held that such facts showed that the agreement was accepted and ratified; also, that it was not an essential prerequisite to such consolidated companies acting as a corporation that the agreement should have upon it the certificates of the several secretaries of each of the railroad companies that it had been accepted. After disposing of this question, it was held further that the organization having assumed to act as a corporation, and issued the bonds secured by the mortgage and put the bonds in circulation, persons holding stock in the corporation, as such, could not

defeat the bonds and mortgage by alleging that the corporation was not duly incorporated.[1] The court held the mortgage valid over the objection that it was not submitted to the corporation for approval, but was the act of its directors.[2]

§ 518. Illustration of a fraudulent mortgage.— A Michigan manufacturing corporation having, in carrying on its business, become involved with a large floating indebtedness, certain new parties, with a view to paying this floating indebtedness, were brought into it. There were subsequent readjustments of the stock of the corporation, which resulted finally in one of those

[1] Phinizy *v.* Augusta & K. R. Co.; Central Trust Co. of New York *v.* Port Royal & Western Carolina Ry. Co., (1894) 62 Fed. Rep. 678. The court said in one place: "It must be kept in mind that the consolidation of railroads does not create a new corporation, with powers of its own, distinct from, greater or less than, those enjoyed by the consolidating companies separately. It is a method provided by law for the formation of a copartnership between railroad corporations, by which, if the expression may be used, they pool their franchises and property, and are enabled to act in complete harmony under one head, as a unit. This unit possesses the powers of its component parts — no more and no less. Pub. Laws, § 1538 (Gen. St. S. C. § 1427). And the act authorizing it provides a method of advertising the state that this copartnership has been formed. No further grant of a franchise is necessary, nor is any given. Indeed, it is an accomplished fact, requiring no further act or deed on the part of the state, or any one else. Gen. St. § 1428 (Pub. Laws, § 1539)." See, also, Wallace *v.* Loomis, 97 U. S. 146.

[2] Phinizy *v.* Augusta & K. R. Co.; Central Trust Co. of New York *v.* Port Royal & Western Carolina Ry. Co., (1894) 62 Fed. Rep. 678. It was said by the court: "Under the law of South Carolina (Gen. St. S. C. §§ 1427, 1428; Pub. Laws S. C. §§ 1538, 1539) it is provided that, upon the consummation of the act of consolidation, the rights, privileges and franchises of each of the corporations, parties to the same, shall be taken and deemed to be vested in and transferred to such new corporation, without any further act and deed. Each of these corporations, at the date of the consolidation, had outstanding bonds secured by mortgage under proper authority. The main purpose of the new mortgage was to take up them and substitute the bonds of the new company. The bonds and mortgage substituted were authorized and sustained by the same powers. 'The directors alone, without the vote of the stockholders, may authorize a mortgage to be made; and even though there is a question as to their authority, the validity of the mortgage, as against the corporation, is established by its affirmance of it by the issue of bonds under it.' Wood R. R. 1951, § 461, quoting McCurdy's Appeal, 65 Pa. St. 290; Hodder *v.* Railroad Co., 7 Fed. Rep. 793. 'If the act authorizing the mortgage requires a concurrence of the majority of stockholders, it is held that this is a requirement in which the public have no interest.' Thomas *v.* Railroad Co., 104 Ill. 462."

who had assumed this floating indebtedness having one share of the stock issued to his brother, and there was a new election of officers. The two brothers, one as president, and the other as secretary and treasurer, and the third party as vice-president, were elected. A meeting of the directors was then called and a resolution adopted, the two brothers voting for it, the third party against, which authorized the execution of a chattel mortgage upon the whole plant and stock to secure a large note then held by transfer to him by their father. Under a bill for foreclosure of this mortgage a receiver was appointed and a decree for sale, and the property was sold and purchased by the father and a bank holding the other note, these notes representing the original floating indebtedness which the defendant in this action assumed. The declaration alleged that the introduction of the brother of this defendant into the corporation, the readjustment of the shares of stock, the change made in the officers of the corporation, the transfer of the notes, the resolution directing the execution of the chattel mortgage, and the sale of the property, were acts done in pursuance of a fraudulent scheme to relieve the former president of the corporation from his obligations, to appropriate the assets, goods and plant, and deprive the plaintiff, the only other shareholder, of his interest in the corporation, and that the defendants unlawfully conspired together to accomplish the desired purpose. The Supreme Court of Michigan held that the declaration set forth a cause of action. They said: "The right of the directors of a corporation to execute a mortgage to secure its indebtedness does not include the right of a member of that corporation, who is under obligations to carry the corporation paper, to introduce a dummy into the board of directors, and, confederating with him, direct the execution of a mortgage to another confederate, to whom the paper has been assigned for the purpose of avoiding these obligations, wrecking the corporation and appropriating its assets; nor does the right of a creditor to foreclose include the right of such confederate fraudulently to obtain the security for the purpose named and to foreclose it in furtherance of that purpose." [1]

§ 519. What corporation mortgages cover, and what they do not cover.— It is settled that the after-acquired property

[1] Hanley *v.* Balch, (1892) 94 Mich. 315, 319.

clause in a mortgage of railroad property is valid, and that thereby the mortgage covers not only property then owned by the railroad company, but becomes a lien upon all property subsequently acquired by it which comes within the description in the mortgage.[1] And this is true, not only as to property to which it acquires the legal title, but also as to that to which it acquires only a full equitable title.[2] The doctrine that the "after-acquired property" clause in a railroad mortgage covers not only legal acquisitions, but also all equitable rights and interests subsequently acquired either by or for the railroad company, has been reaffirmed by the Supreme Court of the United States.[3] The language of a railroad mortgage covering, among other things, all the corporate rights, privileges, franchises and immunities, and all other things in action, contracts, claims and demands of the said party of the first part, whether now owned or hereafter acquired in connection or relating to said railroad, has been held sufficient to include a subsequently acquired lease of a belt railway whereby the company acquired access to a city at one of its termini.[4] A lien will be created upon the terminal facilities of a railroad company where such company is incorporated to construct a railroad between two cities named as its termini, by a mortgage, expressed to be upon its line of railroad constructed, or to be constructed, between the named termini, together with all the stations, depot grounds, engine houses, machine shops, buildings, erections in any way now or hereafter appertaining under

[1] Central Trust Co. *v.* Kneeland, (1891) 138 U. S. 414. See Pennock *v.* Coe, 23 How. 117; Dunham *v.* Cincinnati, P., etc., Ry., 1 Wall. 254; Galveston Railroad *v.* Cowdrey, 11 Wall. 459; Thompson *v.* Valley Railroad Company, 132 U. S. 68; Omaha & St. Louis Ry. Co. *v.* Wabash, St. Louis & Pac. Ry. Co., (1891) 108 Mo. 298; McTighe *v.* Macon Construction Co., (Ga.) 21 S. E. Rep. 701.

[2] Toledo, etc., Railroad Co. *v.* Hamilton, 134 U. S. 296. The court cited in support of this position Jones on Mortgages, § 138; Massey *v.* Papin, 24 How. 362; Farmers' Loan & Trust Co. *v.* Fisher, 17 Wis. 114; Lincoln Building Assn. *v.* Hass, 10 Neb. 581; Laughlin *v.* Braley, 25 Kans. 147.

[3] Wade *v.* Chicago, Springfield & St. Louis R. R. Co., (1893) 149 U. S. 327; s. c., 13 Sup. Ct. Rep. 892; citing Dunham *v.* Cincinnati, P., etc., Ry. Co., 1 Wall. 254; Galveston Railroad *v.* Cowdrey, 11 Wall. 459; Porter *v.* Bessemer Steel Co., 122 U. S. 267; Toledo, etc., Railroad *v.* Hamilton, 134 U. S. 296; Central Trust Co. *v.* Kneeland, 138 U. S. 414. As to the priority of a railroad mortgage covering after-acquired property under the Iowa statutes, on rolling stock delivered to the railroad company, before its use, on the depot grounds, see Manhattan Trust Co. *v.* Sioux City & N. Ry. Co., 68 Fed. Rep. 72.

[4] Columbia Finance & Trust Co. *v.* Kentucky Union Ry. Co., (1894) 60

the described line of railroad, and will not be limited to so much of the road as is found between the city limits of those places.[1] A railroad mortgage on an entire line of railroad between named points, "as said railroad now is or may be hereafter constructed, maintained, operated or acquired, together with all the privileges, rights, franchises, real estate, right of way, depots, depot grounds, side tracks, water tanks, engines, cars and other appurtenances thereto belonging," has been held by the Supreme Court of Missouri to cover land subsequently purchased by the company near a depot on the line of its road, and a hotel erected thereon for the purpose of an eating house and to accommodate the

Fed. Rep. 794; citing Trust Co. *v.* Kneeland, 138 U. S. 416; s. c., 11 Sup. Ct. Rep. 357; Railroad Co. *v.* Hamilton, 134 U. S. 297; s. c., 10 Sup. Ct. Rep. 546; Branch *v.* Jesup, 106 U. S. 468; s. c., 1 Sup. Ct. Rep. 495. As to what such mortgages cover, see Cooper *v.* Corbin, 105 Ill. 224; First Nat. Bank of Salem *v.* Anderson, 75 Va. 250; Nichols *v.* Mase, 94 N. Y. 160; McAllister *v.* Plant, 54 Miss. 106; Morgan & Raynor *v.* Donovan, 58 Ala. 241; Kelly *v.* Trustees, 58 Ala. 489; Butler *v.* Rahm, 46 Md. 541; Pullan *v.* Cin. & Chic. Air Line R. R. Co., 5 Biss. 237; Calhoun *v.* Memphis & Paducah R. R. Co., 2 Flip. 442; Seymour *v.* Canandaigua & Niagara Falls R. R. Co., 25 Barb. 284; Willink *v.* Morris Canal & Bkg. Co., 4 N. J. Eq. 377; Eldridge *v.* Smith, 34 Vt. 484; Elwell *v.* Grand St. & Newtown R. R. Co., 67 Barb. 83; Farmers' Loan & Trust Co. *v.* Commercial Bank of Racine, 15 Wis. 426; Farmers' Loan & Trust Co. *v.* Commercial Bank, 11 Wis. 207; Farmers' Loan & Trust Co. *v.* Fisher, 17 Wis. 114; Fisk *v.* Potter, 2 Abb. Ct. App. Dec. 138; Buck *v.* Memphis & Little Rock R. R. Co., 4 Cent. L. J. 430; Galena & Chic. U. R. R. Co. *v.* Menzies, 26 Ill. 121; Bardstown & Louisville R. R. Co., Metcalfe, 4 Metc. (Ky.) 199; Hunt *v.* Bullock, 23 Ill. 320; Ludlow *v.* Hurd, 1 Disney, 552; Mobile & Cedar Point R. R. Co. *v.* Talman, 15 Ala. 472; Morrill *v.* Noyes, 56 Me. 458; Parkhurst *v.* Northern Central R. R. Co., 19 Md. 472; Phil., Wilm. & Balt. R. R. Co. *v.* Woelpper, 64 Pa. St. 366; Pierce *v.* Emery, 32 N. H. 484; Phillips *v.* Winslow, 18 B. Mon. 431; Pierce *v.* Milwaukee & St. Paul R. R. Co., 24 Wis. 551; Robinson *v.* Atl. & Gt. West. Ry. Co., 66 Pa. St. 160; Shamokin Valley R. R. Co. *v.* Livermore, 47 Pa. St. 465; Walsh *v.* Barton, 24 Ohio St. 28; Youngman *v.* Elmira & Williamsport R. R. Co., 65 Pa. St. 278; Parish *v.* Wheeler, 22 N. Y. 494; Morgan County *v.* Thomas, 76 Ill. 120; Raymond *v.* Clark, 46 Conn. 129; Buck *v.* Seymour, 46 Conn. 156; Palmer *v.* Forbes, 23 Ill. 301; Farmers' Loan & Trust Co. *v.* Hendrickson, 25 Barb. 484; Beardsley *v.* Ontario Bank, 31 Barb. 619; Taylor *v.* Burlington, Cedar Rapids & Minn. Ry. Co., 4 Dill. 570; Addison *v.* Lewis, 75 Va. 701; Dean *v.* Biggs, 25 Hun, 122; Titus *v.* Mabee, 25 Ill. 257; Resor *v.* Ohio & Miss. R. R. Co., 17 Ohio St. 139. For an illustration of what was, and what was not, covered by the "after-acquired" property clause in a corporation mortgage, see Boston Safe Deposit & Trust Co. *v.* Bankers & Merchants' Telegraph Co., (1888) 36 Fed. Rep. 288.

[1] Central Trust Co. *v.* Kneeland, (1891) 138 U. S. 414. Mr. Justice Brewer, speaking for the court, said: "The stations, depot grounds, etc., in the terminal cities appertain to the railroad as fully as similar structures in places intermediate those termini. In the absence of restrictive words such is the natural import, and, therefore, must be adjudged the intent and scope of a mortgage containing that description. The first mortgage contains not only the general terms referred to, but after them, and as if it were to avoid any possible doubt, adds: 'And all its depot grounds, yards, sidings, turnouts, sheds, machine shops, leasehold rights, and other terminal facilities now or hereafter owned by the said party of the first part.' It would be difficult to make language more full, accurate and descriptive." See Willink *v.* Morris Canal & Bkg. Co., 4 N. J. Eq. 377; Morris & Essex Railroad *v.* Central Railroad Co., 31 N. J. L. 205; Mohawk Bridge Co. *v.* Utica & Schenectady Railroad, 6 Paige, 554; Commonwealth *v.* Erie & Northeast Railroad, 27 Pa. St. 339.

[1] Omaha & St. Louis Ry. Co. *v.* Wabash, St. Louis & Pac. Ry. Co., (1891) 108 Mo. 298. See U. S. Trust Co. of New York *v.* Wabash, St. L. & Pac. Ry. Co., 32 Fed. Rep. 480, where the court ordered the money arising from insurance on the building paid over to the receiver, who represented the first mortgage creditors. The court distinguished Humphreys *v.* McKissock, Receiver, 140 U. S. 304.

[2] Augusta, Tallahassee & Gulf R. Co. *v.* Kittel. (1892) 52 Fed. Rep. 63.

employees of the company, passengers and other persons.[1] It has been held by the United States Circuit Court of Appeals for the fifth circuit that a mortgage by a railroad company of all and any interest the company might have to the land granted to it by the state of Florida to which it had been donated under the act of congress as to the swamp and overflowed land, passed whatever title the company had, as it had a full equitable title, though it did not have a legal title to the land, by reason of the absence of a patent in the original grant to the state.[2] The congress of the United States by act granted the right of way to the state of Missouri through certain public lands between designated points, and also granted to the state every alternate section of land, properly designated by metes and bounds, for the purpose of aiding in making railroads and branches, and at the same time authorized the legislature to dispose of the lands for the purpose named, and for none other. The state by act afterwards granted some of these lands to a railroad company for the purposes above stated and subject to the terms of the acts of congress, and at the same time authorized the company to issue bonds and secure the same by mortgage on those lands in order to raise funds to construct the railroad. By subsequent legislation the state was authorized to issue aid bonds to this company, none of the bonds to be delivered to the company until it had signified its accept-

ance by filing a receipt therefor with the secretary of state, and that when recorded in the office of the secretary of state each certificate should be a mortgage on the road. The company accepted these bonds and filed the certificates required, and afterwards the state's statutory mortgage lien upon the railroad and its property was enforced by sale. After the donation of these public lands to the company by the state the company made a deed of trust to certain trustees of these lands to secure an issue of bonds, with power in the trustees to sell these lands and take up the bonds, etc. This case was an ejectment case growing out of the sales of these lands for the purposes above stated, and the question was before the court as to what the statutory mortgage of the state covered. It was held by the Supreme Court of Missouri that the lien of the certificates of the company accepting the aid, which by the provisions of the aid act were to be a mortgage "of the road and every part and section thereof and its appurtenances," did not include the railroad lands granted to the company by the state, since they were not appurtenant to the road. Nor did the lien created by the terms of a subsequent act of the legislature authorizing an additional loan of state bonds to this company where the provision was that the bonds so issued "should constitute a first lien or mortgage upon the road and property of the several railroad companies receiving them" extend the state's lien over such railroad lands granted to the state and by the state to the company.[1] A mortgage of all of the property of a corporation formed to supply heat to the public, covers all the franchises essential to the operation of its property.[2] The United States Circuit Court of Appeals for the

[1] Wilson *v.* Beckwith, (1893) 117 Mo. 61; s. c., 22 S. W. Rep. 639. The court discuss and distinguish Whitehead *v.* Vineyard, 50 Mo. 30; Wilson *v.* Boyce, 92 U. S. 323; Chouteau *v.* Allen, 70 Mo. 290, 327; Railroad *v.* McGee, 115 U. S. 469. In McIlhenny *v.* Binz, (Tex.) 13 S. W. Rep. 655, the directors of a railroad company adopted a resolution authorizing a mortgage of its property to render effectual what was attempted to be done in a former mortgage, the validity of the latter being in doubt. As directed by the resolution, the second mortgage was executed. In this latter there was no reference made to the former, and neither the resolution of the directors nor the second mortgage gave expression to any intention that the same property named in the first mortgage should be covered by the second. The Supreme Court of the state of Texas held that in such case the description of the property in the second mortgage could not be decided by that in the first.

[2] Pumphrey *v.* Threadgill, (Tex. Civ. App.) 28 S. W. Rep. 450.

seventh circuit, upon an appeal from an order in a creditor's bill against a water company and the purchasers of its property at foreclosure sale and others, appointing a receiver and ordering the purchasers to surrender the property to the receiver and restraining these purchasers from interfering with the possession of the receiver, sustained the validity of the mortgage and set aside the order of injunction. It was held that the mortgage executed by the water company covered all franchises owned by the company and enumerated in the ordinance of the city granting the same to the company whether the franchises were in fact granted by the city or by the state.[1] After mortgaging its

[1] Andrews *v.* National Foundry & Pipe Works, (1894) 61 Fed. Rep. 782. It was said by the court upon the construction of the mortgage: "The appellants, it is not disputed, advanced large sums of money to the water company in the belief that they were receiving a valid security, and, while they are presumed to have known the law, it is not to be presumed, if there is reasonable escape from it, that either party to the transaction intended a vain thing. '*Interpretatio facienda est ut res magis valeat quam pereat*,' and other familiar maxims, lend support to the requirement that a contract or deed shall be so construed as to have effect rather than so as to be made void. By the literal terms of the mortgage and of the decree of foreclosure, upon which the title of the appellants depends, there was a conveyance or assignment of 'all the rights, privileges, immunities, franchises and powers, of whatever name or nature, which were granted in and by that certain ordinance,' etc., and if, upon a proper interpretation of the statutes touching this question, no mortgageable right, privilege or franchise was granted in or by the ordinance, as distinguished from a direct grant by the corporation, then by a strict construction the mortgage was, as it was held to be, ineffectual and meaningless. But not by the words alone should a writing be interpreted. 'The rule is to regard the intention rather than the words;' and here the evident intention, deducible from the whole instrument, was to mortgage the rights and franchises which the ordinance granted in terms, or which it purported to convey. The resolution whereby the water company declared its acceptance of the ordinance, and 'of the franchise thereby granted,' shows that both parties entertained an equally broad and generous view of the powers of the common council of the city in the premises, and, when the deed of trust came to be drawn, it was only natural that for certainty of description reference should be made to the ordinance by which the rights of the company were defined, and, as the parties supposed, were granted. And even if this supposition was mistaken, must it be held that the entire purpose of the parties failed, and that, notwithstanding the covenant of the water company that it was 'the owner and holder,' and had 'good right and lawful authority' to make transfer and sale 'of said rights, privileges, immunities, franchises and powers' 'in the manner aforesaid,' yet the instrument is a total nullity? Indeed, why should it not be held that by that covenant the water company is estopped to deny that its franchises were granted by the ordinance? Or must it

property a corporation organized for lighting purposes placed dynamos and exciters in the building used by it for the manufacture of electricity, as part of its electric plant, with the intention that they should remain there till worn out or superseded by more suitable machines. The New York Supreme Court has held that they became part of the realty and were subject to the mortgage as against judgment creditors of the corporation notwithstanding they could be removed without impairing the construction of the building.[1] In a case where several railroad companies combined to construct an elevator connected with their respective railroads, each company agreeing to pay its portion of the cost of construction, and to receive a corresponding amount in the shares of stock in a corporation organized for its construction, and to hold title to the same, the Supreme Court of the United States has held that a railroad company joining in such an arrangement, the elevator to be built upon land not belonging to the company, and situated at some distance from its road, did not acquire an interest in the elevator, which would pass as an appurtenance under a mortgage of its railroad as constructed or to be constructed, and the appurtenances thereto belonging.[2]

be said that the covenant covers only the rights and franchises which were granted by the ordinance, and, like the granting clause, is itself void because the franchise came to the company in that way? It would seem more reasonable, the ordinance having been made a part of the deed by reference as if copied into it, to treat the covenant as covering the rights and privileges named in the ordinance, whether derived from one source or another. To say the least, upon the whole instrument, it is only reasonable and in accord with the canons of construction to read the expression 'which were granted,' etc., as if it were 'which in terms were granted unto the said Oconto Water Company in and by that certain ordinance,' etc. The added words are fairly implied, and the addition, without doing violence to any part of the writing, gives effect alike to the words of grant and covenant and accomplishes the evident purpose for which the deed was executed."

[1] New York Security & Trust Co. *v.* Saratoga Gas & Electric Light Co., 88 Hun, 569; s. c., 34 N. Y. Supp. 890. As to fixtures falling within the terms of a mortgage, see Wade *v.* Donau Brewing Co., (Wash.) 38 Pac. Rep. 1009. As to what is covered by a mortgage, see Wood *v.* Whelen, 93 Ill. 153; Despatch Line of Packets *v.* Bellamy Mfg. Co., 12 N. H. 205; Hicks *v.* Cheyenne Land & Live Stock Co., (Wyo.) 35 Pac. Rep. 475. As to "after-acquired" property, see Wood *v.* Holly Mfg. Co., (Ala.) 13 So. Rep. 948.

[2] Humphreys *v.* McKissock, (1891) 140 U. S. 304; s. c., 11 Sup. Ct. Rep. 779; Wabash, St. Louis & Pacific Ry. Co. *v.* McKissock, Ibid. The court below had passed a decree confirming the report of the commissioners, holding that the mortgaging company possessed such an interest. Upon the

§ 520. Trustees of such mortgages — their duty, rights and powers.— Under the general statutes of Minnesota a railroad company may, in a mortgage executed by it, pledge the income of the property, and, to make such pledge effectual, may

point directly involved Mr. Justice FIELD, speaking for the court, said: "Had the elevator been constructed upon property covered by the mortgage it might have been contended that it fell to the extent of the one-sixth interest under the mortgage, as one of the depots of the company. The term 'depot' in the mortgage is not necessarily limited to a place provided for the convenience of passengers while waiting for the arrival or departure of trains. It applies also to buildings used for the receipt and storage of freight, which, when received, is to be safely kept until forwarded by the cars of the company or delivered to the owner or consignee. Such a building, whether existing at the time of the mortgage or constructed afterwards upon the property of the company covered by it, may pass under the mortgage as one of its depots, but will not pass as an appurtenance to the property previously existing. A thing is appurtenant to something else only when it stands in the relation of an incident to the principal and is necessarily connected with the use and enjoyment of the latter. Harris *v.* Elliott, 10 Pet. 25, 54; Jackson *v.* Hathaway, 15 Johns. 447, 455; Linthicum *v.* Ray, 9 Wall. 241. Of two parcels of land one can never be appurtenant to the other, for though the possession of the one may add greatly to the benefit derived from the other, it is not an incident of the other or essential to the possession of its title or use; one can be enjoyed independently of the other. As said by the Court of Appeals of New York in Woodhull *v.* Rosenthal, 61 N. Y. 382, 390: 'A thing 'appurtenant' is defined to be a thing used with and related to or dependent upon another thing *more worthy*, and agreeing in its nature and quality with the thing whereunto it is appendant or 'appurtenant.' It results from this definition that land can never be appurtenant to other land or pass with it as belonging to it. * * * All that can be reasonably claimed is that the word 'appurtenances' will carry with it *easements* and *servitudes* used and enjoyed with the lands for whose benefit they were created. Even an easement will not pass unless it is necessary to the enjoyment of the thing granted.' Under the term 'appurtenances,' as used in the mortgage in question, only such property passes as is indispensable to the use and enjoyment of the franchises of the company. It does not include property acquired simply because it may prove useful to the company and facilitate the discharge of its business. A distinction is made in such cases between what is indispensable to the operation of a railway and what would be only convenient. Bank *v.* Tennessee, 104 U. S. 493, 496. The elevator in question was at all times under an independent management, and was used in the same manner as any other warehouse not on the premises of the railway company to which it sent cars for freight." In New Orleans & Pac. Ry. Co. *v.* Union Trust Co., (1890) 41 Fed. Rep. 717, the railroad company mortgaged the whole of its line in the state of Louisiana; "also all real and personal estate within the state owned by the company at the date of this mortgage, or which may be acquired by it thereafter, appurtenant or necessary for the

stipulate in the mortgage that upon default the trustee named in the mortgage may take possession, operate the railroad and receive its earnings. Under such a stipulation the trustee, upon default, may, without bringing an action to foreclose, take possession, and, if he be prevented, may have an action to be put in possession.[1]

operation of said line." The special authority given in its charter to the company to mortgage did not authorize it to mortgage an after-acquired land grant. And the Code of Louisiana provided that "future property can never be the subject of conventional mortgage." The federal court for the eastern district of Louisiana held that the mortgage did not affect land thereafter granted to the company to aid in the construction of the road. In New Chester Water Co. *v.* Holly Manufacturing Co., (1892) 53 Fed. Rep. 19, affirming 48 Fed. Rep. 879 (a bill to establish and enforce a lien on pumping engines for the purchase price), where the water company, on a sale of pumping engines for its water works, expressly agreed that the seller, the manufacturing company, should have a lien thereon with full right of possession until the price was paid, the United States Circuit Court of Appeals for the third circuit held that this showed an intent that the pumping engines should not become a part of the realty, and under the Pennsylvania decisions this intent was controlling and the lien was not waived in favor of the mortgage bondholders or other creditors by attaching the engines to the foundation in the usual manner. As to the general rule of law uncontrolled by local statutes governing conditional sales, the court referred to Harkness *v.* Russell, 118 U. S. 663; s. c., 7 Sup. Ct. Rep. 51, as containing an elaborate discussion of the whole subject. They said further: "The present case does not fall within the class of cases * * * in which it has been held that the rails and bridges of a railroad of necessity become a permanent part of the whole structure, and, therefore, cannot be made the subjects of special liens, but is more analogous to the class in which the rolling stock of a railroad company has been held to be the subject of a conditional sale, and on which a lien may be reserved by the vendor. And this appears to be reasonable. Locomotive engines and cars are as essential to the operation of the railroad as pumping engines are to waterworks, but it has been held that the former may be treated as personal property, and as such may be liable to a lien in favor of the seller, which will not be lost in consequence of a prior mortgage which by its terms was made to cover after-acquired property. U. S. *v.* New Orleans & O. R. Co., 12 Wall. 362." In Metropolitan Trust Co. *v.* New York, L. E. & W. R. R. Co., 45 Hun, 84, where there was an agreement by a railroad company with another, as to promoting the business of the former on the part of the latter, in consideration of the latter's giving the former the control of a majority of its stock, and the former road agreed to make good any deficiencies in the net earnings of the latter to meet the interest on its bonds secured by a mortgage of its property by the latter in usual form, the undertaking on the part of the former to make up this deficiency in earnings was held neither to be embraced in nor covered by the mortgage.

[1] Seibert *v.* Minneapolis & St. Louis Ry. Co., (1893) 52 Minn. 246; s. c., 53 N. W. Rep. 1151.

Trustees, under their power in a railroad mortgage, under certain circumstances, as for default in payment of interest for a limited period, to declare all the bonds secured by the mortgages to be past due, must exercise this power with the utmost good faith, and only when approved by their honest, disinterested judgment, as the best thing for the interest of the bondholders.[1] The trustees in a trust deed of a railroad company having, in a suit to be placed in possession of the property, obtained a decree that they are entitled to possession, under the provisions of the trust deed, will be entitled, there being no debts for current expenses, to receive all profits of the road earned from the commencement of their suit.[2] The trustees in a railroad mortgage, having entered into possession of the property by reason of nonpayment of the interest on the bonds, according to the terms of the mortgage, where the principal of the bonds has not matured, on the interest being paid, may be compelled to surrender the possession of the property if the mortgage deed in no way requires a course to the contrary.[3] Trustees under a trust deed with covenants of warranty from a railroad company may pay a prior incumbrance to prevent a forced sale of the property embraced in their deed; and when paying such they are subrogated to the rights of the holder of that prior incumbrance.[4] There was a provision in a trust deed executed by a land grant railroad company to secure its bonds that the proceeds arising from the sales of the lands should be applied by the trustees: *First*, to the payment of the interest coupons attached to the bonds, should the earnings of the road be insufficient for their payment; *second*, to the purchase of outstanding bonds at their market value, not exceeding ten per cent premium; *third*, to the payment of bonds coming due. There was also a provision for the investment of the proceeds of the sales not thus used. The holders of certain interest coupons, there being no funds at one time to pay them, accepted scrip of the company, payable in ten years, with the right on the part of the company to take the scrip up at any time. They surrendered their coupons to the trustees, to hold as collateral. The United States Supreme Court held that it was the duty of the trustees at a subsequent time, when

[1] Bound *v.* South Carolina Ry. Co., (1892) 50 Fed. Rep. 853.

[2] Dow *v.* Memphis & Little Rock R. R. Co., 8 Sup. Ct. Rep. 673.

[3] Union Trust Co. *v.* Missouri, Kansas, etc., Ry. Co., 26 Fed. Rep. 485.

[4] Memphis & Little Rock R. R. Co. *v.* Dow, 120 U. S. 287.

the earnings of the road proved sufficient to pay the current coupons, and the business of the company promised that this would continue, and the outstanding bonds of the company could not be bought up on the terms allowed in the trust deed, and investments could not be made except at a lower rate of interest than the scrip held by these former holders of coupons bore, to apply the funds in their hands to the payment of the coupons which were represented by the scrip.[1] A mortgage executed by a railroad company, to secure its bonds, recited that it was deemed expedient to fund certain coupons of prior bonds by the issue of scrip convertible into bonds, and that the bonds which this mortgage was executed to secure had been issued for that purpose. The validity of this mortgage being in doubt, the bonds were destroyed and never issued. Another issue of bonds was made, secured by another mortgage, after which the first mortgage was released by the trustees named therein. In a case before it the Supreme Court of Pennsylvania held that the holders of the coupons referred to in the first mortgage acquired no vested interest in the mortgage which had been released, and that they were in no position to object to the release.[2] The trust companies, acting as trustees in certain railroad mortgages executed by Texas railroad companies, representing the bondholders whose bonds were secured by these several mortgages, brought actions in the United States Circuit Court for the western district of Texas against the railroad companies involved and against the state railroad commissioners and the attorney-general of the state, alleging that the full interest on the bonds was not being paid or earned; that in most cases the earnings were even insufficient to pay operating expenses; that the railroad companies were willing and anxious to meet all their obligations to complainants, but were prevented from exercising their judgment and discretion in making remunerative rates of transportation by the defendant railroad commissioners, under pain of the severe penalties prescribed by the act providing for this board of railroad commissioners. The claim of the bill was that the act was unconstitutional, and prayed for an injunction restraining these commissioners from interfering with the railroad companies in the matters complained of. Their right to maintain the action was questioned before the court.

[1] Little Rock & Ft. Smith Ry. Co. *v.* Huntington, 7 Sup. Ct. Rep. 517.

[2] Commonwealth *v.* Wilmington & N. R. R. Co., (Pa.) 17 Atl. Rep. 5.

The court held, however, that these trustees for bondholders showed a sufficient interest in the roads to entitle them to maintain the suits.[1]

[1] Mercantile Trust Co. *v.* Texas & Pac. Ry. Co., (1892) 51 Fed. Rep. 529. McCormick, Circuit Judge, said: "The complainants here show equitable interest in the fair earnings of the roads; they show actual ownership and possession of the mortgage securities of the roads, both of which they allege are being irreparably injured and threatened with destruction by the defendants; they show that the railways are willing and want to meet all their obligations as mortgagors in possession, but that said railways are coerced by the defendants, armed with the Railroad Commission Act, and the directors cannot exercise their judgment and discharge their duty as they should and would but for said coercion. It may be that the railway companies could, under section 6 of the Railroad Commission Laws, or without the authority of that section, have brought these suits and obtained all the relief to which the complainants are entitled against the other defendants, or it may be that they could not. If they could not, that would be only one additional reason why the complainants should sue; and, if the railways could have so sued, that would be no reason for denying the complainants any right, even if, as seems to be hinted rather than charged, the railways could only have resorted to the state courts; and that there was a previous understanding between the complainants and the railways that the relief complainants desired and believed themselves entitled to receive, would be more likely to be speedily and adequately extended in the national courts. It was to meet such cases that the national courts were established. In them parties 'may hope to escape the local influences which sometimes disturb the even flow of justice.' Davis *v.* Gray, 16 Wall. 221. What has already been said expresses sufficiently my view as to the suggestion, and the authority in its support, that the injury inflicted and threatened, if any, was done and directed to the mortgagor in possession, and is too remote to give the complainants the right to sue. It may be conceded that there is no express decision of the Supreme Court or of other courts of authority on this question, but as to this point the case of Peik *v.* Railway Co., in 94 U. S. 164, is substantially the same as these cases. That case was strongly controverted. Lawyers of the highest national reputation argued it elaborately and at great length in the Supreme Court. The same question was involved in the case of Stone *v.* Trust Co., 116 U. S. 307; s. c., 6 Sup. Ct. Rep. 334, 388, 1191; and while the failure to raise or notice this question in the progress and decision of those cases prevents their being relied on as authority on this point, the fact that it was not raised or noticed is persuasive in the direction of the inclination of my judgment in this case that complainants show a right to one. The case of Murdock *v.* Woodson, 2 Dill. 188, persuades to the same conclusion."

CHAPTER XXVII.

INSOLVENCY OF PRIVATE CORPORATIONS.

§ 521. How far the assets of an insolvent corporation are a trust fund for its creditors.
522. The power of directors of a corporation to execute an assignment of the corporation's property for the benefit of creditors.
523. Preferences of creditors by insolvent corporations.
524. Attachment of property of insolvent corporation — the rights of a creditor to attach — lien of its attachment, etc.
525. Receivers — rules as to appointment.
526. Removal of receivers and assignees.
527. The rights of receivers and assignees as to property of insolvent corporation.
528. Other rights of receivers and assignees of insolvent corporations.
529. Insolvent beneficial association — rules.
530. Liability of stockholders on unpaid subscriptions — the court's right to enforce and how enforced.
531. Creditors' bills — equitable jurisdiction.
532. Claims against insolvent corporation — rules as to allowance, etc.
533. Rules in cases of insolvent banks.

§ 521. How far the assets of an insolvent corporation are a trust fund for its creditors.— The Court of Appeals of West Virginia held that an assignee of an unsound savings bank was entitled to recover from a director of the bank money which he had withdrawn as his deposit in the bank, not in cash, but in bills and notes discounted by the bank, which property of the bank had been turned over to him by the cashier. JOHNSON, President, for the Court of Appeals of West Virginia, then applied the principles evolved from a review of cases to the case before the court, in these words: "It seems to me that the doctrine that the directors of a corporation do not sustain a fiduciary relation to the creditors, is based on no better reason than that a natural person or the member of a partnership do not sustain a confidential relation to their creditors. Is this reason a sound one? Is there no difference between the natural person and the *artificial person* called a corporation? A person goes into mercantile business. He is worth, it may be, one hundred thousand dollars. His creditors trust him more on the faith of his property than his

business management. They know that his liability is unlimited; that all he has is held for his debts. Not so with a corporation. In this state, as well as others, no stockholder, after he has paid his stock subscription, is liable personally for any part of the debts of the corporation. The [savings institution here involved], according to the evidence, in 1870 had a capital of fifty thousand dollars, yet the depositors lost about three hundred thousand dollars, six times as much as the whole capital stock. This corporation, by its directors, was by law permitted to carry on business, receive deposits, etc., and its stockholders would have reaped all the profits after the debts were paid, and yet are not personally liable for the debts of the corporation. The corporation has conferred upon it a privilege, which the natural person does not possess; and the modern authorities, recognizing this distinction and the great necessity for strict management of its affairs, have declared that its assets are a trust fund for the payment of creditors. Some of the authorities declare that the capital stock is a trust fund for the payment of the debts of the creditors. If the capital stock is, then why not that which represents the capital stock? Fifty thousand dollars, say, is paid in as the stock subscription. This money is loaned and bills and notes taken therefor. The fifty thousand dollars in cash is gone, but there is its equivalent with its accumulated earnings. If the capital stock is a trust fund for the payment of the debts of the corporation, then, I think, all the assets of the corporation are a trust fund for the same purpose. Why should this not be true? It is a very old doctrine, as old as corporations themselves, that the stockholders are not entitled to receive anything from the corporation until its debts are paid. If that is so, it seems to me it follows that the creditors are entitled to all the assets of the corporation, if necessary, for the payment of their debts. But if the assets of a corporation are a trust fund for the payment of the debts, who holds the property in trust? The directors are the managers of the corporation, and it has long been held that they are trustees for the corporation and its stockholders. They are to prudently and faithfully manage the affairs of the corporation, pay its debts, and divide the residue among the stockholders. They must necessarily look after the debts before they can discharge their trusts to the stockholders. If the assets are a trust fund for the payment of the debts of the corporation, it necessarily follows that the direct-

ors, in whose hands are those funds, are the trustees for the creditors of the corporation. When the directors of a banking corporation ascertain that it is hopelessly insolvent, so that individually they are unwilling longer to aid it, their manifest duty is to close its doors at once, for continuing to do business then (as receiving deposits) is a fraud upon the public, and they should not receive any more deposits nor pay any more checks, but should proceed to execute their trust, either by making a general assignment for the benefit of creditors, or by paying *pro rata* the debts of the corporation. Whether the board of directors could then, under peculiar circumstances, make preference of creditors, as was done in Burr *v.* McDonald, 3 Gratt. 216, it is unnecessary to decide in this case. But the directors had no right, occupying the fiduciary relation to the creditors generally which they did, to keep the doors of the [savings institution] open, until they could get out their deposits, and all the time from the 21st of February, 1871, until the 25th of the said month, luring depositors to give credit to the insolvent concern, while some of them, at least, including the defendant in this cause, were receiving their money from deposits thus improperly received. Before [defendant] received his money, the directors, under the evidence in this cause, should have closed the doors of the institution. Under these circumstances he had no right to draw his money, and thus prefer himself to the other creditors, for whom he was acting as trustee. To do so was a gross breach of trust and was also fraud."[1] The

[1] Lamb, Trustee, *v.* Laughlin, (1884) 25 W. Va. 300, 321, 322. The cases to sustain the director's position reviewed were Poole, Jackson & Whyte's Case, 9 Ch. Div. 322; Dana *v.* U. S. Bank, 5 Watts & Serg. 223; Catlin *v.* Eagle Bank, 6 Conn. 233; Pondville Co. *v.* Clark, 25 Conn. 97; Smith *v.* Skeary, 47 Conn. 47; Whitwell *v.* Warner, 20 Vt. 425; Stratton *v.* Allen, 1 C. E. Green (N. J.), 232; Daniels *v.* Davison, 16 Ves. 249; Moore *v.* Butler, 1 Scho. & Lef. 262; Railroad *v.* Claghorn, 1 Speers Eq. 562; Buell *v.* Buckingham, 16 Iowa, 291; Merrick *v.* Peru Coal Co., 61 Ill. 472; Burr *v.* McDonald, 3 Gratt. 216; Addison *v.* Lewis, 75 Va. 720; Planters' Bank *v.* Whittle, 78 Va. 737. The cases to the contrary were Wood *v.* Dummer, 3 Mason, 308; Curran *v.* Arkansas, 15 How. 308; Drury *v.* Cross, 7 Wall. 302; Koehler *v.* Black River Falls Iron Co., 2 Black, 720; Sawyer *v.* Hoag, 17 Wall. 610; Upton *v.* Tribilcock, 91 U. S. 47; Jackson *v.* Ludeling, 21 Wall. 616; County of Morgan *v.* Allen, 103 U. S. 498; Shea *v.* Mabry, 1 Lea (Tenn.), 319; Hastings *v.* Drew, 76 N. Y. 9; Goodin *v.* Canal Co., 18 Ohio St. 182; Richards *v.* Insurance Co., 43 N. H. 263; Colby *v.* Copp, 35 N. H. 434; Jones, McDowell & Co. *v.* Arkansas Mechanical & Agricultural Co., 38 Ark. 17; Bradley *v.* Farwell, 1 Holmes, 433; Coons & Braine *v.* Tome, 9 Fed. Rep. 532.

Supreme Court of the United States, in a late case, after a reference to cases which had been determined by that court, has said: "These cases negative the idea of any direct trust or lien attaching to the property of a corporation in favor of its creditors, and at the same time are entirely consistent with those cases in which the assets of a corporation are spoken of as a trust fund, using the term in the sense that we have said it was used. The same idea of equitable lien and trust exists in the case of partnership property. Whenever, a partnership becoming insolvent, a court of equity takes possession of its property, it recognizes the fact that in equity the partnership creditors have a right to payment out of those funds in preference to individual creditors, as well as superior to any claims of the partners themselves. And the partnership property is, therefore, sometimes said, not inaptly, to be held in trust for the partnership creditors, or that they have an equitable lien on such property. Yet all that is meant by such expressions is the existence of an equitable right which will be enforced whenever a court of equity, at the instance of a proper party, and in a proper proceeding, has taken possession of the assets. It is never understood that there is a specific lien, or a direct trust. A party may deal with a corporation in respect to its property as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called to an account for fraud or sometimes even mere mismanagement in respect thereto; but as between itself and its creditors, the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. That is certainly the general rule, and if there be any exceptions thereto, they are not presented by any of the facts in this case. Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together, gave to these simple contract creditors any lien upon the property of the corporation, nor charged any direct trust thereon."[1] In a late case before the

[1] Hollins *v.* Brierfield Coal & Iron Co., (1893) 150 U. S. 371. They referred to the cases in these words: "In the case of The Wabash, St. Louis & Pacific Railway *v.* Ham, 114 U. S. 587, it appeared that four railway corporations owing debts were consolidated under authority of law,

Supreme Court of Nebraska that court held that the relation of the directors and managing officers of an insolvent private corporation towards the property and assets thereof is that of trustees for all of the creditors, and such officers cannot take advantage of their position to secure a preference for themselves, but are required to share ratably with other creditors.[1]

and by the terms of the consolidation agreement the new corporation was to protect the debts of the old. Subsequently the new corporation executed a mortgage on all its property, and in a contest between the mortgagees and the unsecured creditors of one of the constituent companies the court held that the lien of the mortgagees was prior. In respect to this, Mr. Justice GRAY (p. 594) thus stated the law: 'It was contended that the property of the Toledo and Wabash Railway Company was a trust fund for all its creditors, and that upon the consolidation the Toledo, Wabash and Western Railway Company took the property of the Toledo and Wabash Railway Company charged with the payment of all its debts. The property of a corporation is doubtless a trust fund for the payment of its debts, in the sense that when the corporation is lawfully dissolved and all its business wound up, or when it is insolvent, all its creditors are entitled in equity to have their debts paid out of its corporate property before any distribution thereof among the stockholders. It is also true in the case of a corporation as in that of a natural person that any conveyance of property of the debtor, without authority of law and in fraud of existing creditors, is void as against them.' The case of Fogg *v.* Blair, 133 U. S. 534, 541, presented a similar question, and this court, by Mr. Justice FIELD, observed: 'We do not question the general doctrine invoked by the appellant that the property of a railroad company is a trust fund for the payment of its debts, but we do not percive any place for its application here. That doctrine only means that the property must first be appropriated to the payment of the debts of the company before any portion of it can be distributed to the stockholders; it does not mean that the property is so affected by the indebtedness of the company that it cannot be sold, transferred or mortgaged to *bona fide* purchasers for a valuable consideration, except subject to the liability of being appropriated to pay that indebtedness. Such a doctrine has no existence.' In the case of Hawkins *v.* Glenn, 131 U. S. 319, 332, which was an action brought by the trustee of a corporation against certain of its stockholders to recover unpaid subscriptions, and in which the defense of the Statute of Limitations was pleaded, Chief Justice FULLER referred to this matter in these words: 'Unpaid subscriptions are assets, but have frequently been treated by courts of equity as if impressed with a trust *sub modo* upon the view that, the corporation being insolvent, the existence of creditors subjects liabilities to the rules applicable to funds to be accounted for as held in trust, and that, therefore, statutes of limitations do not commence to run in respect to them until the retention of the money has become adverse by a refusal to pay upon due requisition.'" See further on this subject Ford *v.* Plankinton Bank, (Wis. 1894) 58 N. W. Rep. 766, and an article by Seymour D. Thompson, one of the judges of the Court of Appeals of St. Louis, in 27 Am. Law Rev. 846.

[1] Ingwersen *v.* Edgecombe, (Neb. 1894) 60 N. W. Rep. 1032. The court considered the weight of authority as to the relation of the trustees to be in favor of the statement in the text, and cited in support of their judgment Haywood *v.* Lumber Co., 64 Wis. 639; s. c., 26 N. W. Rep. 184; Hopkins' Appeal, 90 Pa. St. 69; Sicardi *v.* Oil Co., 149 Pa. St. 139; s. c., 24 Atl. Rep. 163; Olney *v.* Land Co., 16 R. I. 597; s. c., 18 Atl. Rep. 181; Rouse *v.* Bank, 46 Ohio St. 493; s. c., 22 N. E. Rep. 293; Hays *v.* Bank, 51 Kans. 535; s. c., 33 Pac. Rep. 318; Thompson *v.* Lumber Co., 4 Wash. St. 600; s. c., 30 Pac. Rep. 741, and 31 Pac. Rep. 25; Corey *v.* Wadsworth, (Ala.) 11 So. Rep. 350; Adams *v.* Milling Co., 35 Fed. Rep. 433; 2 Dillon Mun. Corp. 787, 803; Beach Priv. Corp. 241 et seq.; Wait Insol. Corp. 162. As to the doctrine of the assets of a corporation being a trust fund for its creditors, see Alberger *v.* National Bank of Commerce, 123 Mo. 313; s. c., 27 S. W. Rep. 657; Fear *v.* Bartlett, (Md.) 32 Atl. Rep. 322; O'Bear Jewelry Co. *v.* Volfer, (Ala.) 17 So. Rep. 525, overruling Corey *v.* Wadsworth, 99 Ala. 68; s. c., 11 So. Rep. 350; Goodyear Rubber Co. *v.* George D. Scott Co., 96 Ala. 439; s. c., 11 So. Rep. 370, and Gibson *v.* Furniture Co., 96 Ala. 357; s. c., 11 So. Rep. 365. See, also, Worthen *v.* Griffith, 59 Ark. 562; s. c., 28 S. W. Rep. 286; Chattanooga, R. & C. R. Co. *v.* Evans, 14 C. C. A. 116; s. c., 66 Fed. Rep. 809.

§ 522. The power of directors of a corporation to execute an assignment of the corporation's property for the benefit of creditors.—The Supreme Court of Missouri has held that a private corporation, having the power to make an assignment for the benefit of creditors, and the management of its affairs being vested in the directors without restriction, the directors, and they alone, are authorized to make it; that when the corporation becomes crippled and unable to meet its obligations in the usual course of business it is the duty of the directors to care for the creditors, and it is competent for the directors to make an assignment, and this they may do without the consent of the stockholders.[1]

[1] Hutchinson *v.* Green, (1886) 91 Mo. 367, 375; s. c., 1 S. W. Rep. 853. The court cited Chew *v.* Ellingwood, 86 Mo. 260; Dana *v.* The Bank of the United States, 5 W. & S. 223; De Camp *v.* Alward, 52 Ind. 473, in support of this conclusion. The court said: "The directors may with propriety consult with the stockholders, but under the circumstances just stated, and in the exercise of their best judgment, they may make the assignment even against the expressed will of the stockholders. Of the cases relied upon by the [stockholders attacking this assignment] that of Abbott *v.* American Hard Rubber Co., 33 Barb. 580, was not an assignment for the benefit of creditors. There the trustees attempted, through the form of a sale, to secure to themselves the property of the corporation at the expense of the other stockholders. The sale was voidable as to the stockholders not consenting, although a majority agreed to the transaction. No question of the validity of a voluntary assignment of an insolvent corporation made for the benefit of creditors was involved in the case. The same may be said of Northern Railroad *v.* Concord Railroad, 50 N. H. 175, for there the purpose of the contract brought in

§ 523. Preferences of creditors by insolvent corporation. — The right of a railroad company in this case to make preferences among its creditors was brought in question. The United States Circuit Court for the eastern district of Arkansas held that under the decisions of the courts of Arkansas, and at common law, an insolvent corporation may make preferences among its creditors in good faith, so long as its right to do so is not restrained by statute.[1] A corporation in failing circumstances

question was to transfer the management of the affairs of one company to the other for a period of five years. The assignment was upheld in Eppright *v.* Nickerson, 78 Mo. 482, though the stockholders did not authorize or assent to it. In that case the assignment was not assailed by any stockholder, and the court, by way of concession, made some remarks which seem to imply that consent on the part of the stockholders was essential to give validity to an assignment as against them, but of these remarks enough was said in Chew *v.* Ellingwood, 86 Mo. 260." As to the power of a corporation to make an assignment for the benefit of creditors, see Shockley *v.* Fisher, 75 Mo. 498. As to assignments for benefit of creditors, see In re Lehigh Co.'s Estate, 12 Pa. Co. Ct. Rep. 257; National Bank of Commerce *v.* Shumway, 49 Kans. 224; Potts *v.* Wallace, 146 U. S. 689; s. c., 13 Sup. Ct. Rep. 196; Vanderpoel *v.* Gorman, 22 N. Y. Supp. 541.

[1] Gould *v.* Little Rock, M. R. & T. Ry. Co., (1892) 52 Fed. Rep. 680; citing Ex parte Conway, 4 Ark. 302, 348, 354; Ringo *v.* Biscoe, 13 Ark. 563. CALDWELL, Circuit Judge, said: "The established rule in [Arkansas] is in harmony with the general, though not quite uniform, current of authorities in this country on the question. 2 Mor. Corp. § 802; Allis *v.* Jones, 45 Fed. Rep. 148; Covert *v.* Rogers, 38 Mich. 363; Coats *v.* Donnell, 94 N. Y. 168; Dana *v.* Bank, 5 Watts & S. 223; Warner *v.* Mower, 11 Vt. 390; Whitwell *v.* Warner, 20 Vt. 426; Stratton *v.* Allen, 16 N. J. Eq. 229; Wilkinson *v.* Bauerle, 41 N. J. Eq. 635; s. c., 7 Atl. Rep. 514; Duncomb *v.* Railroad Co., 84 N. Y. 190; 88 N. Y. 1; Harts *v.* Brown, 77 Ill. 226; Reichwald *v.* Hotel Co., 106 Ill. 439; Buell *v.* Buckingham, 16 Iowa, 284 (opinion by Judge DILLON); Hallam *v.* Hotel Co., 56 Iowa, 178; s. c., 9 N. W. Rep. 111; Garrett *v.* Plow Co., 70 Iowa, 697; s. c., 29 N. W. Rep. 395; Smith *v.* Skeary, 47 Conn. 47; Bank *v.* Whittle, 78 Va. 737; Ashhurst's Appeal, 60 Pa. St. 314; Sargent *v.* Webster, 13 Met. 497." Then he discusses the question generally: "In some states, by statute, the property of an insolvent corporation must be devoted to the payment *pro rata* of all its creditors, and, after the insolvency of the corporation is known, the directors cannot divert its property from such use by giving preferences to some of its creditors; but where there is no such statute the great weight of authority is that the property of an insolvent corporation may be held and used by its directors in the payment of some of its creditors to the exclusion of others. Its insolvency does not affect its right to make preference any more than the right of an individual debtor to make preferences is affected by his insolvency. The cases which hold the contrary doctrine are bottomed on the erroneous theory that the insolvency of a corporation, in effect, dissolves it, and makes

may, in Missouri, prefer one creditor to another in discharging its obligations, if such preference is made in good faith, while the property of the corporation remains in its possession and unaffected by liens or by process of law. Such a preference is not invalidated by the subsequent act of the failing corporation in making a general assignment on the same day for the benefit of its creditors. Nor is such a preference rendered fraudulent because the amount of property transferred is largely in excess of the

the directors mere trustees to distribute its assets ratably among its creditors. It is undoubtedly true that the property of a corporation is in one sense a trust fund for the payment of its debts; but this rule means no more than that the property of a corporation cannot be distributed among its stockholders, or applied to any purpose foreign to the legitimate business of the corporation until its debts are paid. The rule, so far as it relates to the payment of debts, is satisfied whenever the property of a corporation is applied to the payment of any of its *bona fide* debts. The rule, as has been often pointed out, does not prevent a corporation, whether solvent or insolvent, from making preferences among its creditors, and exercising in good faith absolute dominion over its property in the conduct of its legitimate corporate business, so long as its right to do so is not restrained by statute or by judicial proceedings. In Fogg *v.* Blair, 133 U. S. 534, 541; s. c., 10 Sup. Ct. Rep. 338, Mr. Justice FIELD, in delivering the opinion of the court, calls attention to the fact that the property of a corporation is not a trust fund for creditors in any other sense than we have stated. He says: 'We do not question the general doctrine invoked by the appellant that the property of a railroad company is a trust fund for the payment of its debts, but do not perceive any place for its application here. That doctrine only means that the property must first be appropriated to the payment of the debts of the company before any portion of it can be distributed to the stockholders. It does not mean that the property is so affected by the indebtedness of the company that it cannot be sold, transferred or mortgaged to *bona fide* purchasers for a valuable consideration, except subject to the liability to be appropriated to pay that indebtedness. Such a doctrine has no existence. The cases of Curran *v.* State, 15 How. 304, 307, and Wood *v.* Dummer, 3 Mason, 308, give no countenance to anything of this kind.' The case of Rouse *v.* Bank, 46 Ohio St. 493; s. c., 22 N. E. Rep. 293, is cited in support of the proposition that the property of an insolvent corporation is a trust fund for its creditors in a sense that precludes the corporation from making preferences among its creditors or otherwise using its property in the conduct of its corporate business. Referring to the doctrine of this case, the Supreme Court of the United States, speaking by Mr. Justice GRAY, says: 'That decision, it is true, proceeded in part upon the theory that the property of an insolvent corporation is a trust fund for its creditors in a wider and more general sense than could be maintained upon general principles of equity jurisprudence. Graham *v.* Railroad Co., 102 U. S. 148, 161; Railroad Co. *v.* Ham, 114 U. S. 587, 594; s. c., 5 Sup. Ct. Rep. 1081; Richardson's Exrs. *v.* Green, 133 U. S. 30, 44; s. c., 10 Sup. Ct. Rep. 280;

debt thereby preferred.[1] They held also that the mere insolvency of a corporation does not of itself transform its assets into a trust fund for the equal benefit of all creditors.[2] The Illinois Supreme Court has declared the settled law of that state to be that corporations may prefer creditors; that the corporate property of the corporations is not held in trust in such sense as to forbid the corporation from giving judgment notes, confessions of judgments or mortgages, or doing any other matter or thing in the exercise of the right they have to prefer one creditor to another. As to what is required of the officers of the corporation in such transactions, they declared the rule to be that the persons to whom the corporation intrusts the exercise of its right to prefer creditors, must exercise the trust in the utmost good faith, without regard to the extent of their personal interest in the corporation or its property; and that the fact that the corporation may be embarrassed with debts, or may be well nigh or wholly insolvent, will not lessen the duty to exercise with fairness the power given them. The officers, as they represent the corporation, have no right to join creditors or stockholders hostile to the corporation

Fogg *v.* Blair, 133 U. S. 534, 541; s. c., 10 Sup. Ct. Rep. 338; Peters *v.* Bain, 133 U. S. 670, 691, 692; s. c., 10 Sup. Ct. Rep. 354;' Purifier Co. *v.* McGroarty, 136 U. S. 237; s. c., 10 Sup. Ct. Rep. 1017. A good many courts have from time to time inveighed against the rule of the common law which allows a debtor to make preferences among his creditors, but the rule is too firmly imbedded in our system of jurisprudence to be overthrown by judicial decision, and it can no more be overthrown by the courts in its application to corporations than to individuals. In Wilkinson *v.* Bauerle, 41 N. J. Eq. 635; s. c., 7 Atl. Rep. 514, the court said: 'Both reason and authority establish the proposition that a corporation may sell and transfer its property, and may prefer its creditors, although it is insolvent, unless such conduct is prohibited by law.' We think this is a correct statement of the rule, and that it can only be abrogated by legislation."

[1] Alberger *v.* National Bank of Commerce, (Mo. 1894) 27 S. W. Rep. 657. Upon the second point the court cited Union Bank *v.* Kansas City Bank, (1889) 136 U. S. 223; s. c., 10 Sup. Ct. Rep. 1013. As to the second, Hargadine *v.* Henderson, (1888) 97 Mo. 375; s. c., 11 S. W. Rep. 218; Jaffray *v.* Mathews, (Mo. 1894) 25 S. W. Rep. 187.

[2] Alberger *v.* National Bank of Commerce, (Mo. 1894) 27 S. W. Rep. 657, following La Grange Butter Tub Co. *v.* National Bank of Commerce, (Mo. 1894) 26 S. W. Rep. 710. On the subject of preferences of creditors by a corporation the court cited City of St. Louis *v.* Alexander, (1856) 23 Mo. 524, which was approved in Kitchen *v.* Railway Co., (1878) 69 Mo. 254, and in Foster *v.* Planing Mill Co., (1887) 92 Mo. 87; s. c., 4 S. W. Rep. 260. They distinguished Rouse *v.* Bank, (1889) 46 Ohio St. 493; s. c., 22 N. E. Rep. 293; Lyons-Thomas Hardware Co. *v.* Perry Stove Manufg. Co., (Tex. Sup. 1893) 24 S. W. Rep. 16.

in hostile action to the corporation or its property. They must always act in the interest of the corporation, and adversely to the enemies seeking to destroy the corporation.[1] In Pennsylvania an insolvent corporation may prefer a creditor by a confession of judgment.[2] And a sale under a judgment confessed by an insolvent corporation will not be restrained by a court of equity on the ground that a sale of the corporation's property can be more advantageously conducted in the interests of all the creditors by receivers. For until the rights of the other creditors are violated no one has standing to challenge the execution creditor's rights to use the means provided by law for the enforcement of his claim.[3] The corporation here was a foreign one, organized under the laws of New Jersey, and it was attempted to apply the laws of that state to the case. But the court held that where no disability to make a preference of one creditor before another was imposed upon a foreign corporation by its charter, the prohibition of such a preference by a general enactment of the state where the corporation was chartered could have no extraterritorial effect.[4] In an action for the foreclosure of a chattel mortgage executed by a corporation to secure the claims of certain creditors, it appeared that the corporation afterwards made a general assignment for the benefit of its creditors. The Supreme Court of Michigan declared the rule in that state to be that it is not unlawful for a corporation, though insolvent, to give preferences to its creditors by way of mortgage.[5] A corporation in failing

[1] J. W. Butler Paper Co. *v.* Robbins, (1894) 151 Ill. 588.

[2] Pairpoint Mfg. Co. *v.* Phila. Optical & Watch Co., (1894) 161 Pa. St. 17, following Lake Shore Banking Co. *v.* Fuller, 110 Pa. St. 156.

[3] Pairpoint Mfg. Co. *v.* Phila. Optical & Watch Co., (1894) 161 Pa. St. 17. See, also, Lowry, Trustee, etc., *v.* Phila. Optical & Watch Co., (1894) 161 Pa. St. 123.

[4] Pairpoint Mfg. Co. *v.* Phila. Optical & Watch Co., (1894) 161 Pa. St. 17. As to corporations preferring creditors by assignment in Illinois, and that the law of the state where incorporated has no effect to prevent it, see Warren *v.* First National Bank of Columbus, (1893) 149 Ill. 9.

[5] Bank of Montreal *v.* J. E. Potts Salt & Lumber Co., (1892) 90 Mich. 345; citing Kendall *v.* Bishop, 76 Mich. 634, and others. The court referred to certain cases in that state in these words: "In the case of Town *v.* Bank, 2 Doug. (Mich.) 530, certain creditors were preferred by the corporation in a common-law assignment. It was held that the corporation had the same right to prefer one creditor over another that an individual has. In Turnbull *v.* Lumber Co., 55 Mich. 396, it appeared that the corporation was converting its assets into money as rapidly as possible and paying only certain of the creditors. The corporation was at the time insolvent." Speaking of these acts of the corpo-

circumstances cannot borrow money with which to purchase shares in itself, and give to the person from whom the loan is made a preference over all other creditors by confessing judgments, when insolvent, in favor of the persons loaning the money with actual knowledge of the purpose for which the same was borrowed, when such conduct works a fraud upon *bona fide* creditors, and defeats the collection of their claims.[1] In case an insol-

ration, Mr. Justice CHAMPLIN said: "It being insolvent such action must result in the payment of some to the exclusion of others. Such conduct * * * although legal and proper before a bill is filed against it by a judgment creditor whose execution is returned unsatisfied, becomes improper after the filing of such bill. From that time on no unsecured creditor is entitled to a preference over others. In the case of Hills v. Furniture Co., 23 Fed. Rep. 434, a mortgage had been given by an insolvent corporation to secure certain creditors. It was said: 'It does not affect the question if the company could never pay its debts in full, for the legal right of an insolvent debtor to secure one or more creditors, in preference to others, where no fraud is intended, is settled in Michigan by many decisions.'"

[1] Adams & Westlake Co. *v.* Deyette, (S. D. 1894) 59 N. W. Rep. 214. The court, discussing the subject generally, said: "The property and capital of a corporation gives it financial standing, because it is primarily liable for its debts. Persons extending credit to such corporations do so upon the faith that its officers and agents will conduct its affairs in a manner consistent with business principles, and when such officers devote the corporate assets to their individual use and benefit to the exclusion of creditors courts without hesitation characterize such acts, as to creditors, fraudulent and void. Independently of the question of actual fraud in the case under consideration, the immediate effect of the purchase of the Trask stock at a time when the corporation was financially embarrassed, if not, indeed, insolvent, was to increase its liability, without adding anything to its resources to which plaintiff could look for the security or payment of its claim, and such conduct is contrary to the spirit, if not the letter, of our statute, and is not upheld by the courts. Comp. Laws Dak. §§ 2917, 2928. In Currier *v.* Slate Co., 56 N. H. 262, the court says: 'The funds of an insolvent corporation cannot be taken to buy a portion of its capital stock. * * * It would be grossly inequitable to the other stockholders, and a fraud upon creditors.' From Coppin *v.* Greenlees, 38 Ohio St. 275, we quote the following: 'The doctrine that corporations, when not prohibited by their charter, may buy and sell their own stock, is supported by a line of authorities, but nevertheless we think the decided weight of authority, both in England and the United States, is against the exercise of the power, unless conferred by an express grant or clear implication. * * * It is true, however, that in most jurisdictions where the right of a corporation to traffic in its own stock has been denied, an exception to the rule has been admitted to exist whereby a corporation has been allowed to take its own stock in satisfaction of a debt due it. This exception is supposed to rest upon a necessity which arises in order to avoid loss.' If a corporation to the injury of creditors can borrow money for the purchase of one share of its stock, or the stock held by one member, it can borrow money with which to purchase the shares of all its members and thus destroy its very existence, as no corporation like the defendant can have an existence in this jurisdiction without stock and without stockholders. The doctrine is well established that a purchase of shares in itself by a corporation is against public policy and *ultra vires*, whenever such purchase diminishes its ability to pay its debts or lessens the security of its creditors. Bank *v.* Wulfekuhler, 19 Kans. 60; Gill *v.* Balis, 72 Mo. 424; Barton *v.* Plank Road Co., 17 Barb. 397; Clapp *v.* Peterson, 104 Ill. 26; 1 Spell. Priv. Corp. 168, and cases there cited."

[1] Holbrook, Merrill & Stetson *v.* Peters & Miller Co., (Wash. 1894) 36 Pac. Rep. 256. For a case holding that a corporation which has ceased to do business, or by conveying its property to a trustee for the benefit of its creditors incapacitated itself for continuing business, having no power to prefer its creditors, see Lyons-Thomas Hardware Co. *v.* Perry Stove Manuf. Co., (Tex. 1894) 27 S. W. Rep. 100.

vent corporation assigns all its property to one of its creditors for the purpose of satisfying its debt to that creditor, the remedy of the other creditors wishing to attack the assignment is by suit in equity to compel an equal distribution of the corporate assets.[1] A chattel mortgage executed by the president and secretary of an insolvent corporation, with the knowledge and consent of all the stockholders, has been held to be valid by the Supreme Court of Michigan.[1] The Supreme Court of Illinois has held that the general statute of New York prohibiting the assignment or transfer of property in contemplation of insolvency had no application to an assignment of a fund in Illinois executed in Ohio by a New York corporation.[2]

§ 524. Attachment of property of insolvent corporation — the right of a creditor to attach — lien of the attachment, etc. — A Colorado corporation, a land company, in proceedings in insolvency to wind it up and obtain an equitable distribution of its assets, was placed in the hands of a receiver, and the receivership was extended to lands in another state. The United States Circuit Court of Appeals for the eighth circuit held that the court of equity which had appointed this receiver had no

[1] Kalamazoo Spring & Axle Co. *v.* Winans, Pratt & Co., (Mich. 1895) 64 N. W. Rep. 23.

[2] Warren *v.* First National Bank, (Ill. 1895) 38 N. E. Rep. 122. Transfers of property of insolvent corporations have been held to be void in Brouwer *v.* Harbeck, 9 N. Y. 589 That a deed of assignment made by a corporation under the insolvency laws of Minnesota, regular and complete on its face, cannot be collaterally attacked, see Staples *v.* Schulenberg & Boeckeler Lumber Co., (Minn. 1895) 64 N. W. Rep. 148, following Bank *v.* Schranck, 43 Minn. 38; s. c., 44 N. W. Rep. 524.

power to enjoin a citizen of the other state or jurisdiction from levying an attachment on the lands in that state, unless he was a party, either in person or by representation, in the proceedings in which the receiver was appointed; also, that a lien having been established by such an attachment suit, which neither the receiver nor the corporation's other creditors could divest, there was nothing to prevent a party to the receivership proceedings from taking an assignment of the judgment and lien, with all the rights of enforcement belonging to the original owner of the judgment. But the court had authority to enjoin one who had joined in the receivership proceedings and had been active in extending the receivership to the lands in the other state, and afterwards caused suit to be brought in that other state, to collect a debt and thereby obtained a lien on the lands, from enforcing the lien or in any way interfering with the receiver's possession or disposition of the property.[1] Valid attachments of the property of a corporation, made before the filing of a bill for the appointment of a receiver for the corporation, are not dissolved by the filing of such bill and the subsequent appointment of a receiver.[2] The Missouri Supreme Court has in a late case held that, though a corporation is insolvent, a creditor not connected with the corporation may obtain preference, before a court of equity obtains jurisdiction over it for winding up its affairs, by attaching the property of the corporation, though he is advised so to do by a director of the corporation.[3] The Iowa Supreme Court has held

[1] Schindelholz *v.* Cullum, (1893) 55 Fed. Rep. 885. As to property in the hands of a receiver of an insolvent corporation being exempt from being interfered with by an officer under process issued in other cases, see Harrison *v.* Waterberry, (Tex. 1894) 27 S. W. Rep. 109.

[2] Page *v.* Supreme Lodge Knights & Ladies of Protection, (Mass. 1894) 37 N. E. Rep. 369; citing Atlas Bank *v.* Nahant Bank, 23 Pick. 480; Kilborne *v.* Lyman, 6 Met. 299; Hubbard *v.* Bank, 7 Met. 346; Davenport *v.* Tilton, 10 Met. 325; Hills *v.* Parker, 111 Mass. 510; Book Co. *v.* De Golyer, 115 Mass. 69; Sage *v.* Heller, 124 Mass. 213; Garham *v.* Mutual Aid Society, (Mass. 1894) 37 N. E. Rep. 447; Taylor *v.* Insurance Co., 14 Allen, 353; Folger *v.* Insurance Co., 99 Mass. 267; Burdon *v.* Association, 147 Mass. 360; s. c., 17 N. E. Rep. 874.

[3] La Grange Butter Tub Co. *v.* National Bank of Commerce, (Mo. 1894) 26 S. W. Rep. 710. The court declare the principles of law ruling in Missouri courts, in such cases, in these words: "While it may be conceded that corporate assets are regarded as a trust fund for the benefit of all the corporation creditors, the rule, as announced by this court in Foster *v.* Planing Mill Co., 92 Mo. 79; s. c., 4 S. W. Rep. 260, is that a corporation may, when acting within the scope of the purposes for which it was incorporated, do any act in furtherance of those purposes, and, although insolvent, it may prefer some creditors to others, even though such creditors be among the directors of the corporation, provided such preference is made in good faith, and to a *bona fide* creditor. This rule only applies to the acts of the corporation while it is a going concern, and before it has gone into the hands of a receiver, or liens have attached to the corporate property. It is true, as held in Roan *v.* Winn, 93 Mo. 503; s. c., 4 S. W. Rep. 736, and authorities cited, that, after confessed insolvency, the directors of a corporation cannot, in equity, secure any advantages to themselves. This is because they represent all the creditors, and occupy the position of trustees towards them, and a trustee, or a person standing in a similar or fiduciary relation, will not, in equity, be allowed to take advantage of his position, exercise his power, or to manage or appropriate the property of which he has the control, for his own profit and to his own advantage, at the expense of those for whom he is acting."

that an officer of a corporation, who is also its creditor, may attach its property for the collection of his debt, though he knows of its failing circumstances, but is in no way responsible therefor, and though he knows that his attachment will precipitate a crisis in its affairs; and his attachment will be good as against subsequent attaching creditors and mortgagees.[1] Corporations, it has been held in Maryland, are not subjected to the insolvency laws of that state.[2] The property of this corporation was sold by the officers of the federal court at the end of an attachment proceeding. The title of the purchaser was attacked in this action upon the officers' bond. The purpose of the writ of error to the United States Circuit Court of Appeals for the eighth circuit was to present the question whether a business corporation, when it became insolvent, thereafter held all of its property in trust for equal distribution among its creditors, and was deprived of the common-law power of preferring creditors, which individuals ordinarily possessed. The court, on account of the record not presenting it properly, did not determine it. But they did not hold that, if the theory that corporate property is a trust fund for its creditors is invoked to invalidate a conveyance which operates a preference, there was no reason why it should not also operate to prevent complaining creditors from obtaining priority by an attachment. And in this case, the purchaser, in good faith, for full value, without notice of defects in the seller's title, it was held could hold property, as against an attaching creditor of the corporation from

[1] Rollins *v.* Shaver Wagon & Carriage Co., (1890) 80 Iowa, 380; s. c., 45 N. W. Rep. 1037.

[2] Ellicott Machine Co. *v.* Speed, (1889) 72 Md. 22; s. c., *sub nom.* Search *v.* Ellicott, 18 Atl. Rep. 863.

which the seller obtained it, even if the seller had notice of the insolvency of the corporation, and his title would have been invalidated thereby.[1] In case the property of an insolvent foreign corporation has been seized by the sheriff under a warrant of attachment issued by a state court in an action afterwards prosecuted to judgment, an execution issued and levy made upon the property seized, a receiver of such corporation, appointed subsequent to the attachment by the United States Circuit Court of the district where such property is situated, takes the property of the corporation in that jurisdiction, subject to such rights over the same as had been acquired by the various proceedings in the state court.[2] Where funds attached had been paid over to the receiver by order of the court, without prejudice to the rights of the attaching parties, it was held in Massachusetts that the receiver took the property subject to all valid attachments, to the extent of the property lawfully attached before the filing of a bill for a receiver, the claims of the attaching creditors, if allowed to be proved, must be treated as preferred.[3] It has been held by the Court of Civil Appeals of Texas, on a rehearing, that a creditor of an insolvent corporation, obtaining a lien by judicial process on the assets of the corporation, may have the assets applied to the payment of his claim, to the exclusion of other creditors.[4]

[1] Walker *v.* Miller, (1894) 59 Fed. Rep. 869. See Hollins *v.* Iron Co., 150 U. S. 371; s. c., 14 Sup. Ct. Rep. 127; Brown *v.* Furniture Co., 58 Fed. Rep. 286, 292; s. c., 7 C. C. A. 225.

[2] Cole *v.* Oil Well Supply Co., (1893) 57 Fed. Rep. 534.

[3] Page *v.* Supreme Lodge Knights & Ladies of Protection, (Mass. 1894) 37 N. E. Rep. 369; citing Walling *v.* Miller, 108 N. Y. 173; s. c., 15 N. E. Rep. 65.

[4] Harrigan *v.* Quay, (Tex. Civ. App. 1894) 27 S. W. Rep. 897. This case, in the opinion of this court, rendered on appeal, in 26 S. W. Rep, 512, has been remanded so that the creditors of the insolvent corporation other than the one claiming that the assets should be applied first to his attachment, might raise the question whether the property of the insolvent corporation should be administered for the benefit of all the creditors, and that the one proceeding under the attachment was not entitled to any portion of it, except what might be his *pro rata* share of it as a creditor. On the hearing the court held that its former judgment was error, and said: "The rule of law that exists in this state that denies the right of an insolvent corporation, by contract, to transfer its property to a trustee for the benefit of preferred creditors, does not, in our opinion, interfere with the rights of a diligent creditor to pursue the remedies provided by law for the collection of his debt, and subjecting the property of such corporation to its payment. The fact that a corporation may be insolvent does not deprive the creditor of his right to sue it, and to levy upon its property to satisfy his judgment."

§ 525. Receivers — rules as to appointment.—The Court of Chancery of New Jersey, on a bill filed for appointment of a receiver for a corporation, has announced these rules: Nothing short of present actual insolvency will warrant the appointment of a receiver to wind up a corporation. Expected insolvency at some time in the future is not sufficient. A court of equity, in the exercise of its general jurisdiction, may appoint a receiver of a corporation, either because it has no properly constituted governing body or because there are such dissensions in its governing body as to make it impossible for the corporation to carry on its business with advantage to its stockholders; but this power is always exercised with great caution and only for such time and to such an extent as may be necessary to preserve the property of the corporation and to protect the rights of its stockholders.[1] The United States Circuit Court of Appeals for the fifth circuit affirmed the order appointing a receiver in this action by stockholders and bondholders and others, bondholders only, against an Alabama corporation, on the ground that the equities presented

That an attachment cannot be levied under the California rulings on the assets of a bank after the date of its insolvency, as decreed in the proceedings under the California Statutes, for winding up an insolvent bank's business, see Crane *v.* Pacific Bank, (Cal.) 39 Pac. Rep. 215.

[1] Edison *v.* Edison United Phonograph Co., (N. J. Eq. 1894) 29 Atl. Rep. 195. VAN FLEET, V. C., said: "This is the doctrine, as I understand it, which was laid down by Vice-Chancellor MALINS in Featherstone *v.* Cooke, L. R., 16 Eq. 298, and Auxiliary Co. *v.* Vickers, L. R., 16 Eq. 303, and which was approved by Chancellor RUNYON in Einstein *v.* Rosenfeld, 38 N. J. Eq. 309, and by Chancellor MCGILL in Archer *v.* Waterworks Co., 50 N. J. Eq. 33; s. c., 24 Atl. Rep. 508. But neither of the grounds which this doctrine recognizes as sufficient to warrant the appointment of a receiver exists in this case. The defendant corporation has a lawfully constituted governing body, which is in peaceable possession of all its property, controlling and directing its business regularly and peacefully, in conformity to the judgment of seven of its nine directors. Two of the nine differ in judgment from the other seven. The two believe that the adoption of a different course of business from that which is now proposed would result in larger gains. Both methods are clearly within the purposes and powers of the corporation. Which method shall be pursued, or whether one or both, is a question which the law commits absolutely and unconditionally to the judgment of a majority of the directors. Though somewhat disguised, the real purpose of the bill in this case appears, when critically examined, to be to induce judicial action which shall substitute the judgment of a minority of the directors of this corporation for that of the majority. That cannot be done. It is beyond judicial power. No rule of law is better settled than that which declares that so long as the directors of a corporation keep within

in the bill warranted the court to intervene for the preservation of the trust property. The allegations, among others, were that there was an issue of the bonds, when financially embarrassed, by the company, to the amount of $300,000, to raise more money, secured by a mortgage, the greater part of which bonds had been disposed of at or near par and the rest hypothecated for debts; that valuable properties of the corporation had been disposed of at ruinous rates to meet debts of the corporation; that the real estate had been sold for taxes; that default had been made upon the interest of the bonds; that the price of the bonds was depressed to a very low figure; that at a meeting presided over by its president, holding a majority of the proxies, few stockholders being present, it was voted to issue $1,000,000 in bonds; that the trustee had brought no suit to foreclose the mortgage made to secure the principal and interest of the bonds; that the management was wasteful and extravagant and entirely controlled by the president of the corporation.[1] The Supreme Court of Minnesota has held that in an action brought under the provisions of the General Statutes of 1878, chapter 76, for the purpose of sequestrating the property of an insolvent corporation and enforcing the constitutional liability of its stockholders, the plaintiff was not entitled, on the pleadings and as a matter of absolute right, to have a receiver appointed when it appeared that proceedings were pending under the Insolvency Law, in which a receiver or assignee had been designated or selected, who had qualified, and under the supervision of the court had entered upon and was dis-

the scope of their powers, and act in good faith and with honest motives, their acts are not subject to judicial control or revision. The statement of the principle of Vice-Chancellor GREEN in Ellerman *v.* Stock Yards Co., 49 N. J. Eq. 217, 232; s. c., 23 Atl. Rep. 287, is adopted by the court, and the same was restated by the same vice-chancellor in Sewell *v.* Beach Co., 50 N. J. Eq. 717, 723; s. c., 25 Atl. Rep. 929. Chancellor MCGILL, in Benedict *v.* Construction Co., 49 N. J. Eq. 23. 36; s. c., 23 Atl. Rep. 485, expressed it in these words: 'If stockholders in a corporation disapprove of the company's management, which is conducted without fraud, or by actions not *ultra vires*, or not in gross abuse of trust, or shall consider their speculation a bad one, their remedy is to elect new officers or sell their shares and withdraw. Where the question is one of mere discretion in the management of corporate business, or of doubtful event in the undertaking in which the corporation had embarked, remedy cannot be had by application to a court of equity.'"

[1] Fort Payne Coal & Iron Co. *v.* Sayles, (1893) 55 Fed. Rep. 360. As to appointment of receivers of insolvent corporations, see Straman *v.* North Baltimore Water Works Co., 8 Ohio Cir. Ct. Rep. 89; Ford *v.* Kansas

charging the duties of his trust.[1] Charges in a bill brought by one stockholder against a corporation and the other stockholders, that the president of the corporation refuses to account for money intrusted to him for the interests of the company, or to allow any

City & I. S. L. R. Co., 52 Mo. App. 439; Espuela Land & Cattle Co. *v.* Bindle, 5 Tex. Civ. App. 18; s. c., 23 S. W. Rep. 819; State *v.* Bank of New England, (Minn.) 56 N. W. Rep. 575; McGeorge *v.* Big Stone Gap Improvement Co., 57 Fed. Rep. 262; Porter *v.* Industrial Information Co., 5 Misc. Rep. 262; s. c., 25 N. Y. Supp. 328; Ralph *v.* Shiawassee Circuit Judge, (Mich.) 58 N. W. Rep. 837; Towle *v.* American Bldg., Loan & Inv. Soc., 60 Fed. Rep. 131; In re Lewis, 52 Kans. 660; s. c., 35 Pac. Rep. 287; Downing *v.* Dunlap Coal, Iron & Ry. Co., (Tenn.) 24 S. W. Rep. 122; Davis *v.* Power Co., 77 Md. 35; Lime City Building, Loan & Sav. Assn. *v.* Black, (Ind.) 35 N. E. Rep. 829; Supreme Sitting of the Order of Iron Hall *v.* Baker, (Ind.) 33 N. E. Rep. 1128; Fort Payne Furnace Co. *v.* Ft. Payne Coal & Iron Co., (Ala.) 11 So. Rep. 439; Showalter *v.* Improvement Co., 83 Tex. 162; Fluker *v.* Railway Co., 48 Kans. 577; Hinckley *v.* Pfister, 83 Wis. 64; s. c., 53 N. W. Rep. 21; Zieverink *v.* Kemper, (Ohio) 34 N. E. Rep. 250; Davis *v.* United States Electric Power & Light Co., (Md.) 25 Atl. Rep. 982; Merchants' Nat. Bank *v.* Manuf. Co., 48 Minn. 361. Effect of appointment upon an attachment. Waverly Co. *v.* Worthington Co., 24 N. Y. Supp. 331. Jurisdiction in such matters. Glines *v.* Supreme Sitting Order of Iron Hall, 22 Civ. Pro. Rep. 437; s. c., 20 N. Y. Supp. 275. Where the claims against a corporation were ascertained and small in comparison with the property sought to be sequestrated, and no notice of the application for a receiver under the statutes of Virginia had been given to the corporation, and an offer had been made to secure those claims should they be established by giving any bond that might be required, it was held that it was error to appoint such a receiver in Va., Tenn. & Car. Steel & Iron Co. *v.* Wilder, (1892) 88 Va. 942.

[1] Walther *v.* Seven Corners Bank, (Minn. 1894) 59 N. W. Rep. 1077. As to the power of a court in California to appoint a receiver for an insolvent bank, see People's Home Sav. Bank *v.* Court, 103 Cal. 27. As to power of bank commissioners in California in winding up an insolvent bank's affairs, see Long *v.* Court, 102 Cal. 449. When a receiver will be appointed for an insolvent corporation. Hale-Berry Co. *v.* Diamond State Iron Co., (Ga.) 22 S. E. Rep. 217; Mosher *v.* Supreme Sitting of Order of Iron Hall, 34 N. Y. Supp. 816; Security Savings & Trust Co. *v.* Piper, (Idaho) 40 Pac. Rep. 144; San Antonio & G. S. R. Co. *v.* Davis, (Tex. Civ. App.) 30 S. W. Rep. 693; Hatfield *v.* Cummings, (Ind.) 40 N. E. Rep. 53; Cotton Mills *v.* C. C. Randleman Cotton Mills, 115 N. C. 475; s. c., 20 S. E. Rep. 770. When a receiver should be appointed on a bill by stockholders of a corporation asking for such an appointment. Jones *v.* Pearl Mining Co., (Colo.) 38 Pac. Rep. 700; State *v.* Second Judicial District Court of Silver Bow County, (Mont.) 39 Pac. Rep. 316; Downing *v.* Coal Company, 93 Tenn. 221. When a stockholder is not entitled to have a receiver appointed for the corporation. Little Warrior Coal Co. *v.* Hooper, (Ala.) 17 So. Rep. 118. When a receiver should not be appointed. United Electric Securities Co. *v.* Louisiana Electric Light Co., 68 Fed. Rep. 673; Original

inspection of the books by this stockholder, and an affidavit filed with the bill charging that the president is insolvent, and since the inauguration of the suit had mortgaged all his real estate with intent to defeat the claim of the company, there being no allegation of fraud on the part of the other stockholders, but rather a distinct intimation that the president was sustained by them, and the solvency of the corporation being unquestioned, it has been held would not justify a court, before the time for answer has expired, in granting a motion for the appointment of a receiver, and thereby taking the corporation out of the control of the large majority of stockholders.[1] On a motion for a receiver of a corporation in this action, it was held that an allegation that the assets of the corporation were insufficient to pay all its liabilities, including its capital stock as a liability of the corporation to its stockholders, was not sufficient to show that the corporation was insolvent.[2] The United States Circuit Court for the western district of Virginia refused to appoint a receiver for a business corporation upon mere allegations of insolvency, unaccompanied by a charge of fraud, mismanagement or wasting of assets, whereby the plaintiff's claim would be imperiled. Besides, the plaintiff's affidavits as to insolvency were opposed by other affidavits denying the facts and alleging that the appointment of a receiver would be injurious to the interests of all parties, including creditors.[3] That the property of a corporation subject to levy under a judgment of a state court was unsalable by reason of its unmarketable condition, though valuable, and the further fact that the sheriff was so situated with reference to the property, that he could not execute the writ, has been held by the federal court

Vienna Bakery, Coffee & Natatorium Co. *v.* Heissler, 50 Ill. App. 406; Klee *v.* E. H. Steele Co., (Minn.) 62 N. W. Rep. 399; Doe *v.* North West Coal & Transportation Co., 64 Fed. Rep. 928; Cook *v.* East Trenton Pottery Co., (N. J. Eq.) 30 Atl. Rep. 534.

[1] Ranger *v.* Champion Cotton Press Co., (1892) 52 Fed. Rep. 609.

[2] Hagenbeck *v.* Hagenbeck Zoological Arena Co., (1893) 59 Fed. Rep. 14. When a corporation is insolvent. Corey *v.* Wadsworth, (Ala.) 11 So. Rep. 350, overruling Corrugating Co. *v.* Thacher, 87 Ala. 458; s. c., 6 So. Rep. 366; Woolverton *v.* George H. Taylor Co., 43 Ill. App. 424: Albitzue *v.* Guadelupe y Caloo Min. Co., (Tenn.) 22 S. W. Rep. 739. As to when a corporation is insolvent, see Atwater *v.* American Exchange Nat. Bank, 152 Ill. 605; s. c., 38 N. E. Rep. 1017; Mish *v.* Main, (Md.) 31 Atl. Rep. 799; French *v.* Andrews, 81 Hun, 272; s. c., 30 N. Y. Supp. 796.

[3] Lawrence Iron Works Co. *v.* Rockbridge Company, (1891) 47 Fed. Rep. 755.

not sufficient to warrant the appointment of a receiver for the corporation by that court.[1] In this case it was held that the action of the directors, at a meeting of this corporation, the president, secretary and treasurer only were present, in voting themselves salaries, which, however, were never collected, was void, and certain irregularities in the management were not sufficient to justify appointing a receiver for the corporation, it being shown that no actual fraud was intended.[2] The Supreme Court of Wisconsin has declared these rules as to sequestration of the property of an insolvent corporation and having it administered through a receiver: "It is within the function of the Circuit Court to supervise and compel the directors of insolvent corporations to perform their duties as trustees for the corporate creditors in the administration of the corporate property. To that end, in a proper case, by sequestration, it will lay hold of the corporate estate and administer it by its receiver. A proper case for the intervention of the court arises whenever execution on a judgment against a domestic corporation has been returned unsatisfied. Then the court, in an action for that purpose by the execution plaintiff, will sequester the property and effects of the corporation and put it into the hands of a receiver to wind up its affairs and distribute its assets among its creditors.[3] To make the sequestration effectual, it will enjoin other creditors from pursuing their own remedies, and will compel all officers of the law to turn over to the receiver all property of the corporation held by them on attachment or execution, to the end that there shall be a fair and just division of the assets of the corporation among all its creditors, according to law."[4] A portion of the stockholders of a corporation have no absolute right to the appointment of a receiver, though the corporation be insolvent, in the absence of fraud or mismanagement.[5] The Supreme Court of Iowa has held that a court of equity has jurisdiction to appoint a receiver of a state banking association on the petition of a stockholder; and where it shows, and the facts are admitted, such a state of financial affairs of the bank as indicate its hopeless insolvency, a receiver

[1] Buckeye Engine Co. *v.* Donau Brewing Co., (1891) 47 Fed. Rep. 6 (creditor's bill).

[2] Hardee *v.* Sunset Oil Co., (1893) 56 Fed. Rep. 51.

[3] Rev. Stat. Wis. §§ 3216–3228.

[4] Ford *v.* Plankinton Bank, (Wis. 1894) 58 N. W. Rep. 766; citing in support of the rules Ballin *v.* Loeb, 78 Wis. 404; s. c., 47 N. W. Rep. 516.

[5] Denike *v.* New York & Rosendale Lime & Cement Co., 80 N. Y. 599.

should be appointed.[1] There was a receiver appointed in the United States Circuit Court for the northern district of Illinois for a building and loan association organized under the laws of that state. A receiver, afterwards appointed by a state court, applied to the United States court by petition, asking that the receiver appointed by the latter court be ordered to surrender to him the assets of the corporation. The petition was denied and the court upheld its jurisdiction in the matter, holding that courts of equity have jurisdiction to appoint receivers to administer the assets of insolvent corporations. Also that a shareholder in a building and loan association, the officers of which association had so mismanaged its affairs that its assets amounted to less than two-thirds of the capital paid in, was entitled to have the corporate assets placed in the hands of a receiver. Upon special points of objection to the jurisdiction of the United States court it was held that in such a suit by a shareholder for the appointment of a receiver of a corporation, the amount in controversy was the value of the entire corporate assets. The court also declined to dismiss the suit by the stockholder on the ground that the parties to the suit had been collusively arranged for the purpose of creating a case cognizable in the federal courts, as it appeared that the assets of the corporation were in different states, and that its shareholders resided in different states, and, therefore, it was desirable to have all the corporate affairs wound up under a homogeneous management.[2]

§ 526. Removal of receivers and assignees.— The United States Circuit Court for the district of Oregon ordered the removal of a receiver of a corporation who had been appointed at the suggestion of parties representing one of two hostile factions or interests in the corporation on the ground that he was the nominee of the hostile party bitterly opposed by the other, whose appointment was made in the mistaken belief that all interests were united in him.[3] In a Minnesota case, where a trusted

[1] Dickerson *v.* Cass County Bank, (Iowa, 1895) 64 N. W. Rep. 395.

[2] Towle *v.* American Building, Loan & Inv. Soc., (1894) 60 Fed. Rep. 131.

[3] Wood *v.* Oregon Development Co., (1893) 55 Fed. Rep. 901. The district judge said: "It was said by Mr. Justice MILLER, in Meier *v.* Railway Co., 5 Dill. 478: 'It becomes a duty of the court to see that its powers are exercised on principles of strict neutrality as regards the belligerents; and this can be done in this case by removing the representatives of these hostile interests and appointing a receiver, who, in feeling and in conduct, will be strictly neutral and strictly honest.' The receiver is solely the officer of this court. He must be, in the full sense of the term, the 'representative of the court.' He is in no way the representative of either party. His past relations, the influences that secured his appointment, his sympathies, from whatever cause, must not be such as to predispose him either way. He must be the appointee of the court."

and confidential employee of an insolvent corporation was selected for its assignee by its president, who held a majority of its stock, had obtained illegal preferences to indemnify him against his indorsements for the corporation, and who guaranteed the assignee a certain compensation for a specified time for his services as assignee, and such assignee, after accepting and entering upon the trust, made an agreement with said president and certain other preferred creditors who were not residents of this state, to hold and collect for them, as their trustee, securities in his hands as assignee which had been received by the insolvent as collateral to other securities delivered by it to such creditors as an illegal preference, retaining such collateral in its hands, and the assignee, to assist him in the performance of his trust as assignee, employed the former attorney of the insolvent, the Supreme Court held that the assignee should have been removed, under the circumstances stated, on the application of a minority in number or amount of the creditors.[1]

§ 527. The rights of receivers and assignees as to property of insolvent corporations.— A corporation in Wisconsin being insolvent, as charged, confessed judgment to certain creditors, and under their executions property of the corporation was sold by the sheriff; the moneys resulting therefrom being still in his hands, a receiver of the corporation having been appointed by a court having jurisdiction in the suit of other creditors, made his motion in the court for a sequestration of the moneys and an order that they be placed in his hands to be administered for the benefit of all the creditors of the corporation. There was an order for the money to be paid to the receiver, and from this the judgment creditor of the corporation appealed. Upon appeal the Supreme Court affirmed the order of the court below.[2] A cor-

[1] In re Mast, Buford & Burwell Co., (Minn. 1894) 59 N. W. Rep. 1044.

[2] Ford *v.* Plankinton Bank, (Wis. 1894) 58 N. W. Rep. 766. NEWMAN, J., speaking for the court, stated in his opinion the law in that state in such cases to be as follows: "[The verified complaint of the receiver, taken to be true], charges, in effect, that the [corporation] is an insolvent corporation; that after it became in-

poration, before its insolvency, having pledged property with power of sale, a court, after appointing a receiver for such corporation, cannot compel the pledgee to turn over the property to its receiver without first requiring payment of the debt it was pledged to secure. Nor does the appointment of a receiver of the insolvent corporation in such case deprive the pledgee of the property of the right to sell the property in accordance with the

solvent, and while known to be insolvent, both by its directors and the appellant, it colluded and conspired with the appellant and certain others of its creditors named, for the purpose of securing to such creditors unjust and inequitable preference over other creditors of such insolvent corporation; that, as a means of effecting the object of such conspiracy, judgments were confessed by such insolvent in favor of such creditors, executions were issued upon such judgments, and property of the insolvent corporation, to a large amount, was sold, of which sales the moneys so in the hands of the sheriff, and directed to be turned over to the receiver, are the fruit." After stating these allegations the court said: "Assuming what is charged to be true, it seems quite clearly to show a proper case for the sequestration of the property and effects of the insolvent corporation, and *prima facie*, at least, that the appellant and the other creditors named are not justly entitled to the entire fund in the sheriff's hands to the exclusion of other creditors of the insolvent corporation." The court said, as to the contention of the appellant that the moneys in the sheriff's hands, made upon its executions, were not subject to sequestration as the property of the corporation, because it claimed the title to those moneys was in it (the appellant) and not in the corporation: "Probably the appointment of a receiver can affect only such property as is owned by the insolvent at the time of the appointment. And cases are cited which hold that moneys made on execution, while still in the hands of the sheriff, are the property of the creditor. This may be law, as between the debtor and his creditor, in an ordinary case; but it is not controlling here, because, for the purposes of this motion and appeal, it is assumed to be true that the moneys which are in the sheriff's hands are the fruit of an illegal combination between the directors of the insolvent corporation and the appellant for the purpose of giving to the appellant an illegal preference over its other creditors. This is a fraud upon the rights of the other creditors. Fraud taints whatever it touches. No right can grow out of a transaction which fraud has touched. So, upon the present showing, it is held that the moneys were properly directed to be turned over to the receiver as a part of the assets of the corporation. But this does not, of necessity, supersede or displace the appellant's right to the fund. If it has a valid lien, that lien will follow the fund into the hands of the receiver, and the fund will be administered accordingly. The order is not a final determination of its rights. The right is not to be determined on a mere motion; it is to be determined in the motion itself. The rights of the creditors are to be adjusted and determined by the final order or judgment in the action. The statute so directs. Section 3217 of the Revised Statutes provides that it shall be the duty of the court, in the final order in the motion, to direct a just and fair distribu-

contract of the pledger.[1] A court of equity will not take jurisdiction of a suit brought in aid of a judgment at law, where the bill avers that execution has been issued and levied upon the judgment debtor's property, and does not allege that such execution has been returned. In this case, it appearing that the insolvent corporation confessed judgment in a state court in favor of several creditors, and also made a voluntary assignment for the benefit of creditors, it was held that the federal court had no jurisdiction, at the suit of a creditor, brought after the sheriff and assignee had taken possession, to interfere with their disposition of the corporation's property.[2]

§ 528. Other rights of receivers and assignees of insolvent corporations.— Receivers of an insolvent corporation who by order of court collect accounts assigned by the corporation as security are entitled to compensation for their services out of the funds so collected.[3] A suit commenced before the appointment of a receiver of the property of a corporation, upon a claim afterwards filed, within the time limited, against the receiver, may be prosecuted to judgment, which, when rendered, establishes, as against the receiver, the amount of the claim. Should such a

tion of the property of such corporation and of the proceeds thereof among its fair and honest creditors in proportion to their debts, respectively, to be paid in the same order as prescribed in section 3245. Section 3245 provides that all lawful and equitable liens upon the property of such corporation shall be paid in the order of their priority, and before the common debts are paid. The remedy for the enforcement of such rights as the appellant may have is to be brought in the action where the whole estate of the insolvent corporation is being administered. That this is the regular and orderly proceeding in such cases is recognized and made clear by the decision in Aschermann *v.* Bank, (Wis.) 57 N. W. Rep. 349."

[1] National Exchange Bank *v.* Benbrook School Furnishing Co., (Tex. Civ. App. 1894) 27 S. W. Rep. 297; citing on first point Carter *v.* Hightower, 79 Tex. 135; s. c., 15 S. W. Rep. 223; In re Home Provident Safety Fund Assn., 129 N. Y. 288; s. c., 29 N. E. Rep. 323; Hudson *v.* Wilkinson, 61 Tex. 606; Goldfrank *v.* Young, 64 Tex. 437; Risk *v.* Banking Co., 58 Fed. Rep. 45; Schultz *v.* Jerrard, (N. J. Ch.) 3 Atl. Rep. 265; Beach Rec. §§ 80–82; Jones Pledges, §§ 720, 724, 739; King *v.* Insurance Co., 58 Tex. 669. As to power of receivers, see Showalter *v.* Improvement Co., 83 Tex. 162 As to duty of receivers, see Thompson *v.* Huron Lumber Co., 4 Wash. St. 600; s. c., 30 Pac. Rep. 741.

[2] Cleveland Rolling Mill Co. *v.* Joliet Enterprise Co., (1892) 53 Fed. Rep. 683.

[3] Preston Nat. Bank of Detroit *v.* Emerson, (Mich. 1894) 60 N. W. Rep. 981.

receiver know of the pendency of a suit on such a claim afterwards filed against him, a failure on the part of the claimant to refer to the pending suit at the time of the filing of the claim would not cause a waiver of the right to prosecute the action, or constitute an election of remedies. In such a case, however, the receiver should not be charged with the costs both of the suit and of the investigation of the claim before the master, and the creditor should only be allowed the amount of the judgment exclusive of the costs.[1] In a New Jersey case the assignee of one of the directors of an insolvent corporation filed a bill against the receiver of the corporation and others, for the administration of both estates and for the marshaling of assets, and the receiver of the corporation answered, and filed a cross-bill alleging that the directors of the corporation had declared and paid numerous dividends contrary to the statute, which limits their liability for the payment of such illegal dividends to the payment of six years prior to the commencement of the suit. Vice-Chancellor Bird held in the action that it was competent for the receiver to show errors and falsifications of the accounts of the corporation at any reasonable time prior to the commencement of the period of six years within which suit to recover might be had. Also, that although the receiver represented the corporation and produced its books of account, this did not prevent him from contradicting the entries in the books, for the reason that he represented creditors also.[2] A manufacturing corporation had entered into a contract to deliver articles of its manufacture to one who was indebted to it upon its assignment for the benefit of creditors, it becoming insolvent. In an action by the assignee upon this open account the Supreme Court of Minnesota held that the defendant might set off his demand growing out of the contract to deliver goods and failure to deliver on the part of the corporation.[3]

[1] Pine Lake Iron Co. *v.* La Fayette Car Works (Adams, Intervener), (1893) 53 Fed. Rep. 853.

[2] Whittaker *v.* Amwell Nat. Bank (N. J. Eq. 1894) 29 Atl. Rep. 203.

[3] Laybourn *v.* Seymour, (1893) 53 Minn. 105; s. c., 54 N. W. Rep. 941. It was said by the court: "The unsigned order thus 'accepted' by the corporation constituted an express agreement on its part to deliver goods as therein specified; but that was the extent of its obligation in the first instance. While the conditions remained as they were when it was issued, the corporation could not be called upon to pay the specified amount in money nor could the 'acceptance' have been available as a set-off, under the statute against a debt due to the corporation, of the nature of that for which this action is prosecuted; but the making of the assignment under the insolvent law changed the situation and the legal rights of the holder of this instrument. The corporation thereby disabled itself from performing the specific obligation expressed in its written undertaking, and hence subjected itself at once to the alternative liability to answer in damages as for breach of contract. The law does not require the doing of a useless thing, and the corporation having thus disabled itself to specifically perform its agreement, a demand was not necessary to convert the right to demand the goods into a right to compensation in money. The situation of defendants is the same as it would have been if, before the assignment in insolvency, they had demanded the goods, and the corporation, from inability to comply with the demand, or from other cause, had refused to deliver the same."

§ 529. Insolvent beneficial associations — rules.—A court of competent jurisdiction having, by the appointment of a receiver, assumed the administration of the funds of an insolvent benevolent association, it is competent for a court of equity in another state, on a bill filed for that purpose by the receiver, to pay over the funds in their hands to the receiver. And it is no objection to making such an order that the fund in question constitutes a reserve fund, which, by the rules of the association, the central authority could only call in at certain times and for certain purposes and not for the general purpose of liquidating the whole trust fund.[1] As to the distribution of the funds of a mutual benefit association, with branches in several states, becoming insolvent and placed in the hands of a receiver in Massachusetts, it was held that the benefit and reserve funds should be proportionally distributed among the certificate holders regardless of their residence. And to that end certificate holders who may have attached property of the association would be excluded from any share in such funds unless they released such attachments or accounted for the property in their possession.[2]

[1] Failey *v.* Talbee, (1893) 55 Fed. Rep. 892. It was said: "[The laws of the association] undoubtedly do impress upon the funds the character of trust funds, and, perhaps, affect different parts of the fund with different equities; but as to the time and manner of ascertaining and marshaling these equities, and as to the method of administration of the fund accordingly, they must be taken to be abrogated in the case where, as this bill alleges, the society is insolvent. The methods of the court are not to be substituted for the methods provided by the laws." As to the rights of receivers, one being appointed for the supreme body of a benevolent association, and one of a local branch of the same association, see Weiner *v.* Sturgiss, (Md. 1894) 29 Atl. Rep. 613.

[2] Garham *v.* Mutual Aid Society, (Mass. 1894) 37 N. E. Rep. 447. See Fogg *v.* Supreme Lodge, 156 Mass. 431; s. c., 31 N. E. Rep. 289.

§ 530. Liability of stockholders on unpaid subscriptions — the court's right to enforce and how enforced.— The Supreme Court of Tennessee has held that under a general assignment of its assets by an insolvent corporation for the benefit of its creditors, unpaid subscriptions, due from defendant shareholders, passed to the assignee, and that it was his duty to collect them and pay the proceeds to creditors, or, in case of a surplus, to the assignors. They also held that the assignee's right to recover such subscription was not defeated or lost, when, with his permission, the shareholders, other than such delinquent, reorganized the corporation and resumed business, issuing and selling preferred stock and borrowing money, thereby paying some of the debts and acquiring assets sufficient to meet others.[1] A judgment against a corporation and others jointly for the recovery of money is a debt of the corporation, for the purpose of enforcing, as against stockholders, liabilities for unpaid subscriptions and other statutory liability.[2] The doctrine has been declared by the United States Supreme Court that creditors of an incorporated company who have exhausted their remedy at law can, in order to obtain satisfaction of their judgment, proceed in equity against a stockholder to enforce his liability to the company for the amount remaining due upon his subscription to stock, although no account is taken of the other indebtedness of the company, and the other stockholders are not made parties; although, by the terms of their subscriptions, the stockholders were to pay for their shares "as called for" by the company, and the company had not in the case before the court called for more than thirty per cent of the subscriptions.[3] This was an action under the

[1] Cartwright *v.* Dickinson, (1890) 88 Tenn. 476; s. c., 12 S. W. Rep. 1030.

[2] Frost *v.* St. Paul Banking & Investment Co., (Minn. 1894) 59 N. W. Rep. 308.

[3] Hatch *v.* Dana, (1879) 101 U. S. 205. Mr. Justice STRONG, speaking for the court, said: "That unpaid subscriptions are to be regarded as a fund, which the corporation holds for the payment of its debts, is an undeniable proposition." He then states the contentions of the stockholders sued, to which the doctrine of the text is an adverse ruling, and said: "These positions, we think, are not supported by the authorities — certainly not by the more modern ones — nor are they in harmony with sound reason, when considered with reference to the facts of this case. The liability of a subscriber for the capital stock of a company is several, and not joint. By his subscription, each becomes a several debtor to the company, as much so as if he had given his promissory note for the amount of his subscription. At law, certainly, his subscription may be enforced against him without joinder of other subscribers, and in equity

General Statutes of 1878, chapter 76, of Minnesota, for the sequestration of the property of an insolvent corporation and to enforce the constitutional liability of its stockholders for the purpose of paying any balance of indebtedness existing after exhausting the corporate assets. The court held that the corporation

his liability does not cease to be several. A creditor's bill merely subrogates the creditor to the place of the debtor, and guarantees the debt due to the indebted corporation. It does not change the character of the debt attached or garnished. It may be that, if the object of the bill is to wind up the affairs of this corporation, all the shareholders, at least so far as they can be ascertained, should be made parties, that complete justice may be done by equalizing the burdens, and in order to prevent a multiplicity of suits. But this is no such case. The most that can be said is that the presence of all the stockholders might be convenient, not that it is necessary. When the only object of a bill is to obtain payment of a judgment against a corporation out of its credits or intangible property, that is, out of its unpaid stock, there is not the same reason for requiring all the stockholders to be made defendants. In such a case, no stockholder can be compelled to pay more than he owes. In Ogilvie *v.* Knox Insurance Co., 22 How. 380, the question was considered. That was a case in which several judgment creditors of a corporation had brought a creditor's bill against it and thirty-six subscribers to its capital stock. The bill alleged that the complainants had recovered judgments against the company, upon which executions had been issued and returned 'no property;' that the other defendants had severally subscribed for its stock, and that the subscriptions remained unpaid, payment not having been enforced by the company. The prayer of the bill was that these other defendants might be decreed to pay their subscriptions, and that the judgments might be satisfied out of the sum paid. It was objected, as here, that the bill was defective for want of proper parties, but the court held the objection untenable. In delivering the opinion of the court, GRIER, J., said: 'The creditors of the corporation are seeking satisfaction out of the assets of the company to which the defendants are debtors. If the debts attached are sufficient to pay their demands, the creditors need look no further. They are not bound to settle up all the affairs of this corporation, and the equities between its various stockholders, corporators or debtors. If A. is bound to pay his debt to the corporation in order to satisfy its creditors, he cannot defend himself by pleading that these complainants might have got their satisfaction out of B. as well. It is true, if it be necessary to a complete satisfaction of the complainants that the corporation be treated as an insolvent, the court may appoint a receiver, with authority to collect and receive all the debts due to the company, and administer all its assets. In that way all the other stockholders or debtors may be made to contribute.' The court, therefore, directed a decree against the respondents severally for such amounts as appeared to be due and unpaid by each of them for their shares of the capital stock." The court cited, also, Bartlett *v.* Drew, 57 N. Y. 587; Pierce *v.* Milwaukee Construction Co., 33 Wis. 253; Marsh *v.* Burroughs, 1 Woods, 468; Wood *v.* Dummer, 3 Mason 308; and distinguished Pollard *v.* Bailey, 20

ration was not organized for the purpose of carrying on an exclusively manufacturing business, and its stockholders were liable for its debts to the amount of their stock. Also, that the court could not by construction limit this liability by holding that each stockholder was liable only ratably when some of the stockholders were insolvent or beyond the jurisdiction of the court; further, all those who were stockholders at the time the action was commenced were liable, although some of them were not stockholders at the time the corporate liability was incurred.[1] A corporation making an assignment for the benefit of creditors, under the laws of Minnesota relating to such assignments, the court has power to make calls for unpaid subscriptions to stock. And such a case, while it neither determines absolutely the liability of the stockholders, nor has the effect of a judgment, makes whatever the stockholders are liable for within the call become due and payable so that suit may be brought to enforce the liability.[2] The propriety of the call for unpaid subscriptions to stock in this case, and the justification of the call, was before the court. The contentions were such as to require the declaration of rules as to claims against such an insolvent corporation. The court held that under the law proof of claims against the insolvent corporation was, in the first instance, to be made to the receiver or assignee, and his decision upon them, if acquiesced in, would be final. But in case the receiver or assignee allowed a claim, any debtor or other party interested in the assets, or their distribution, might, before the decision of the receiver or assignee became final by acquiescence, apply to the court for, and would be entitled, upon the application, to have a judicial examination and decision as to the allowed claim. But such an examination should be

Wall. 520, and Terry *v.* Tubman, 92 U. S. 156.

[1] First Nat. Bank of Winona *v.* Winona Plow Co., (Minn. 1894) 59 N. W. Rep. 997; citing on the last point, Gebhard *v.* Eastman, 7 Minn. 56.

[2] In re Minnehaha Driving Park Assn., (1893) 53 Minn. 423; s. c., 55 N. W. Rep. 598. The court said: "What remains unpaid on the subscriptions are debts due the corporation, and are its assets. When it is insolvent, they constitute a fund for the payment of its debts. It is true that, as the primary purpose of the proceedings in insolvency is to apply the assets to payment of the debts, the power of the court to make or direct calls for the unpaid subscriptions, and direct the enforcement thereof, must be limited to cases where it is necessary to resort to that fund for the purpose, and the extent of the call must be determined by the amounts of the debts and of the other assets."

applied for in a direct proceeding, and not be a part of, or collateral to, some other proceeding, such as a proceeding to authorize a dividend or to call in the assets.[1] This action by an assignee of an insolvent corporation was brought to recover from its stockholders unpaid stock subscriptions. The complaint alleged merely that no part of the stock owned and held by the several defendants had been paid, except a certain specified amount. The Supreme Court held that evidence was inadmissible to prove that the corporation had accepted, in payment of the stock, property that was greatly undervalued and grossly inadequate in value to the par value of the shares.[2] They held also that it was not an abuse of discretion in the court below to refuse to allow the complaint to be amended on the trial.[3] The Minnesota Supreme Court has held that the statutory liability of stockholders for corporate debts cannot be enforced in insolvency proceedings against the corporation under the act of 1881, but, pending such insolvency proceedings, the creditors may bring an action to enforce the liability of stockholders in an insolvent corporation under the General Statutes of 1878, chapter 76, section 17, in which the court may at once determine the maximum liability of each stockholder, and await the result of the insolvency proceedings to ascertain how much of it shall be enforced by execution.[4]

[1] In re Minnehaha Driving Park Assn., (1893) 53 Minn. 423; s. c., 55 N. W. Rep. 598.

[2] Smith *v.* Prior, (Minn. 1894) 59 N. W. Rep. 1016. The court said: "The cause of action thus attempted to be proved was not one in favor of the corporation, and founded on contract, but one in favor of creditors, and founded on fraud. Hospes *v.* Car Co., 48 Minn. 174; s. c., 50 N. W. Rep. 1117."

[3] Smith *v.* Prior, (Minn. 1894) 59 N. W. Rep. 1016.

[4] Olson *v.* State Bank, (Minn. 1894) 59 N. W. Rep. 635. It was said by the court: "The question was indirectly before us in State *v.* Bank of New England, 56 N. W. Rep. 575, in which it was stated, as a distinction between proceedings against an insolvent corporation under General Statutes of 1878, chapter 76, and insolvency proceedings under the act of 1881, that, under the former proceedings, directors and stockholders may be brought in, and their liabilities to creditors enforced; and it was assumed, or taken for granted, that this cannot be done under the latter proceedings. Chapter 76 clearly contemplates bringing in stockholders for that purpose. If this were not so, then, so far as that chapter is concerned, the creditors would be left to a suit in equity to enforce any liability of stockholders other than such as are deemed assets of the corporation. The statute determines the scope and compass of every special proceeding provided by it, and if authority is not found, either in express terms or by implication, in a statute regulating a special proceeding, for doing a particular thing, there

There has been much litigation growing out of a decree of the Chancery Court of Richmond, Virginia, in the case of what was, at first, a bill of a creditor who had obtained a judgment in Maryland against a Virginia corporation which had become insolvent, and finally its whole business had been abandoned, with a large amount of indebtedness, and no effort on its part to call for and collect out of its unpaid subscriptions to stock, which was eighty per cent of its capital stock, to pay its indebtedness. This creditor's suit was brought against the insolvent corporation, proper service being secured upon it and the trustees named in a certain trust deed executed by the corporation to them for the benefit of its creditors of all its estate, including money payable on assessments, requiring payment of all its debts, but reserving enjoyment for a specified period. Charges of inefficiency and disposition not to enforce the trust were made against these trustees and their removal asked. They were removed in the suit and a trustee substituted, and in his name the proceedings continued, finally resulting in a decree that he recover, by suit or otherwise, of the stockholders an assessment ordered by the court of thirty per cent of their unpaid subscriptions to be applied to the payment of the corporation's large indebtedness. There was no appeal from this decree. In one of the actions brought by this trustee to recover the assessment ordered against the estate of one of the subscribers to stock in Virginia, the case reached the Court of Appeals of that state. This court made these rulings upon the trust deed and the decree of the Chancery Court: The trust deed, construed, as it must be, by the laws of Virginia, was valid; it passed title to all unpaid subscriptions, with power to collect same to extent

is no authority. In Spilman *v.* Mendenhall, (Minn.) 57 N. W. Rep. 468, it was held that the proceeding regulated by General Statutes of 1878, chapter 34, sections 415 to 420, inclusive, being one to dissolve a corporation, settle its business, and convert its assets and apply the proceeds to payment of its debts, stockholders cannot be brought in to answer to their statutory liability, for the reason that the statute does not so provide, though they may be to enforce unpaid subscriptions, because such are assets of the corporation. And it is the same with insolvency proceedings under the law of 1881. There is nothing in that law to suggest that any remedy of creditors who come into the proceeding can be enforced, except as to the assets of the debtor. It is a proceeding merely to convert such assets and apply the proceeds upon the claims of such creditors as come in, and comply with the terms of the law." Actions of receivers of insolvent corporations against stockholders for unpaid subscriptions to stock. Elderkin *v.* Peterson, 8 Wash. 674; s. c., 36 Pac. Rep. 1089.

of call; that the decree of the Chancery Court bound not only the company but the stockholders also, whom the plaintiff, as such trustee and assignee, might, under, and also independently of, the Code of Virginia, sue in his own name for the amount of the call on their subscriptions.[1] Where a court of equity, at a suit of a creditor of an insolvent corporation, directs an assessment on the unpaid stock, such assessment, even though by reason of collusion in obtaining the decree it be larger than necessary to pay the debts, is no invasion of the stockholder's absolute rights, his obligation being that of a debtor to the corporation in the full amount of his subscription. And in such a case a different court would not entertain a suit to enjoin the collection of the assessments directed, so long as it was within the power of the court directing it to correct its mistake by reducing the assessment, or by ordering a ratable return of any surplus remaining after payment of the debts.[2] In one of the suits brought by this

[1] Lewis' Admr. *v.* Glenn, Trustee, (1888) 84 Va. 947. As to the validity of the trust deed, the court cited B. & O. R. R. Co. *v.* Glenn, 28 Md. 287. As to the service upon the company, etc., Glenn, Trustee, *v.* Williams, 60 Md. 93, and authorities there cited.

[2] Furnald *v.* Glenn, (1893) 56 Fed. Rep. 372. TOWNSEND, D. J., said: "In Graham *v.* Railroad Co., 118 U. S. 161; s. c., 6 Sup. Ct. Rep. 1009, the Supreme Court approved the statement of law made by Judge NELSON in the Circuit Court (14 Fed. Rep. 753) as follows: 'In Nougue *v.* Clapp, 101 U. S. 551, it was held that the Circuit Court of the United States cannot revise or set aside a final decree rendered by a state court which had complete jurisdiction of the parties and subject-matter upon the ground that the decree was obtained by fraud, where the injured party has had an opportunity to apply to the state court to reverse the decree. The plaintiff is a party to the foreclosure suit as a shareholder in the old corporation. The state court is still open to listen to the complaint of the corporation and its shareholders. The decree of the foreclosure, though final in one sense, as determining the respective rights of the parties to the property in question, is still in its nature interlocutory, and is open to review by the court, upon petition or motion in the cause, or by bill of review, for good cause shown. The plaintiff has, therefore, an ample and complete remedy for all his alleged grievances in the state court, and there is no occasion for his application to this court for relief by bill in equity.' Judge NELSON in that part of his opinion immediately preceding the foregoing quotation, laid down the rule upon which the complaint relies, with its limitations, as follows: 'It is well settled in the courts of the United States that when a decree or judgment has been obtained against a party to a suit at law or in equity by fraud or deception practiced upon him by his opponent, and he has lost, without fault of his, his remedy of applying to the court for the revocation or reversal of the decree or judgment, a court of equity will afford him relief.' Foster *v.* Railroad Co., 146 U. S. 88; s. c., 13

trustee against a subscriber to shares living in West Virginia to recover the assessment decreed against him, the United States Circuit Court of Appeals for the fourth circuit has held, lately, that in such an action it was no defense that the liability of certain other stockholders on their subscriptions had previously been compromised by the creditors for less than the amounts due, when it appeared that the entire unpaid subscriptions of all the stockholders had to be exhausted in order to satisfy the creditors' claims.[1] The trustee named in a trust deed of the property of a corporation to secure bonds had, for default in interest, demanded possession and it was surrendered to him. Afterwards the trustee filed a bill for foreclosure, and to have a receiver appointed, and to secure unpaid subscriptions of stock from stockholders and an application of the assets for the benefit of the creditors of the corporation. Unsecured creditors having obtained judgment against the corporation, subsequent to the execution of this mortgage, filed a bill alleging the invalidity of the trust deed above referred to, and also praying that the assets of the corporation, unpaid subscriptions, etc., should be, as a result of their proceeding, applied to the payment of their claims. In the meantime, there had been, in the foreclosure suit, a decree of foreclosure and sale of the property. In the United States Circuit Court this later bill was dismissed on its merits. The United States Supreme Court, on appeal, approved the dismissal of the bill but upon the ground of jurisdiction. In discussing this point of the case, it was said by Mr. Justice BREWER, speaking for the majority of the court (Justices BROWN and JACKSON dissenting):

Sup. Ct. Rep. 28; Kent *v.* Iron Co., 144 U. S. 75; s. c., 12 Sup. Ct. Rep. 650. See Glenn *v.* Marbury, 145 U. S. 499; s. c., 12 Sup. Ct. Rep. 914; Foote *v.* Glenn, 52 Fed. Rep. 529."

[1] Bennett *v.* Glenn, Trustee, (1893) 55 Fed. Rep. 956. FULLER, Circuit Justice, said: "It is well settled that decrees against a corporation of the character of those referred to in the pleadings necessarily bind the stockholders in the absence of fraud, and cannot be reviewed or impeached in collateral suits on assessments thereby made. Hawkins *v.* Glenn, 131 U. S. 319; s. c., 9 Sup. Ct. Rep. 739; Glenn *v.* Liggett, 135 U. S. 533; s. c., 10 Sup. Ct. Rep. 867. The decrees [in the Chancery Court of Richmond, Virginia] determined that the entire unpaid balance of the stock subscription was necessary in order to pay the indebtedness of the corporation. The judgment recovered against Bennett in 1884, and paid by him, determined his liability as a holder of fifty shares of stock, and defendants were to that extent at least, concluded in this second suit. Nesbit *v.* Independent Dist., 144 U. S. 610; s. c., 12 Sup. Ct. Rep. 746."

"The plaintiffs were simple contract creditors of the company, their claims had not been reduced to judgment, and they had no express lien by mortgage, trust deed or otherwise. It is the settled law of this court that such creditors cannot come into a court of equity to obtain the seizure of the property of their debtor, and its application to the satisfaction of their claims, and this, notwithstanding a statute of the state may authorize such a proceeding in the courts of the state. The line of demarcation between equitable and legal remedies in the federal courts cannot be obliterated by state legislation. Scott *v.* Neely, 140 U. S. 106; Cates *v.* Allen, 149 U. S. 451. Nor is it otherwise in case the debtor is a corporation and an unpaid stock subscription is sought to be reached. National Tube Works Company *v.* Ballou, 146 U. S. 517; Swan Land & Cattle Company *v.* Frank, 148 U. S. 603, 612. Nor is this rule changed by the fact that the suit is brought in a court in which, at the time, is pending another suit for the foreclosure of a mortgage or trust deed upon the property of the debtor." [1]

[1] Hollins *v.* Brierfield Coal & Iron Co., (1893) 150 U. S. 371, 378, 379, The court further said: "Doubtless in such foreclosure suit the simple contract creditor can intervene, and if he has any equities in respect to the property, whether prior or subsequent to those of the plaintiff, can secure their determination and protection; and here, by the express language of the bill filed by the trustee, all claimants and creditors were united to present their claims and have them adjudicated. These plaintiffs did not intervene, though, as shown by the allegations of their bill, they knew of the existence of the foreclosure suit; neither did they apply for a consolidation of the two suits. On the contrary, the whole drift and scope of their suit was adverse to that brought by the trustee, and in antagonism to the rights claimed by him. They obviously intended to keep away from that suit, and maintain, if possible, an independent proceeding to have the property of the debtor applied to the satisfaction of their claims. But this, as has been decided in the cases cited, cannot be done. The excuse suggested, that the rule which forbids in a suit to foreclose a mortgage the litigation of a title adverse to that of the mortgagor prevented them from intervening, is not sound. Their rights, like those of the trustee and the bondholders, were derived from the corporation defendant. Each claimed under it, and the validity and amount of such claims were matters properly and ordinarily considered and determined in a foreclosure suit. It is true the corporation might admit the validity of any or all of the claims, and then the validity could only be a subject of inquiry as between the claimants for the purpose of determining the matter of priority, but to that extent, at least, both validity and amount are always open to contest and determination." As to enforcing the liability of a corporation holding unpaid shares of the stock of an insolvent corporation, though it may have taken the shares

§ 531. Creditor's bills — equitable jurisdiction.— KEY, D. J., in the United States Circuit Court for the eastern district of Tennessee, sustained the court's jurisdiction in a creditor's bill brought against a railroad construction company, praying an injunction and the appointment of a receiver, upon allegations that the same persons engaged in building a railroad organized the construction company; that nearly all the bonds of the railroad company were issued to it; that the railroad company was insolvent, and in the hands of a receiver, and a decree of foreclosure had been rendered; that the promoters of both companies acquired control of large quantities of the bonds, and in equity held them as trustees for the construction company; that they conspired to strip this latter company of its assets, and in pursuance of the conspiracy diverted large sums of money from its treasury, and pledged its bonds for debts for which it was not liable, and that the construction company was insolvent. The court held that, as it appeared that one of the complainants had a judgment obtained in another state, the bill, as far as he was concerned, might be maintained in the federal court, though his judgment was procured in another state than that in which the federal court sat.[1] Also that the allegations of the bill were sufficient to sustain equity jurisdiction, although the other creditors had not procured judgments as the basis of the suit.[2] The creditors of an insolvent mercantile corpora-

as collateral security for a debt, see Calumet Paper Co. *v.* Stotts Investment Co., (Iowa) 64 N. W. Rep. 782. As to the liability of a stockholder of a bank for the debts of the bank under Minnesota statutes, see Harper *v.* Carroll, (Minn. 1895) 64 N. W. Rep. 145. Rules as to courts' rights to call for unpaid subscriptions to stock of insolvent corporations and the right of receivers and assignees to enforce the liability. Barcalow *v.* Totten, (N. J. Eq.) 32 Atl. Rep. 2; Bennett *v.* Great Western Telegraph Co., 53 Ill. App. 276; Great Western Telegraph Co. *v.* Loewenthal, 154 Ill. 261; s. c., 40 N. E. Rep. 318, affirming 51 Ill. App. 447; Furnald *v.* Glenn, 12 C. C. A. 27; s. c., 64 Fed. Rep. 49.

[1] Merchants' Nat. Bank *v.* Chattanooga Construction Co., (1892) 53 Fed. Rep. 314, following Stutz *v.* Handley, 41 Fed. Rep. 527; Handley *v.* Stutz, 139 U. S. 417; s. c., 11 Sup. Ct. Rep. 530.

[2] Merchants' Nat. Bank *v.* Chattanooga Construction Co., (1892) 53 Fed. Rep. 314. It was said: "Bills in equity, with far fewer elements of original jurisdiction, have been maintained. In the case of Stutz *v.* Handley, 41 Fed. Rep. 537, * * * the court says of that suit: 'Its object being to reach and subject a trust fund, complainants were not even required to have reduced their claims to judgment, and exhausted the remedy at law, after the involving of the company.' Citing Case *v.* Beauregard, 101 U. S. 688-690. Judge HARLAN says in Mellen *v.* Iron Works, 131 U. S. 367; s. c., 9 Sup. Ct. Rep. 781: 'The

tion, the corporators of which, having the full and absolute control of its affairs, having wrongfully misappropriated its assets, so as to put the same beyond the reach of these creditors, may, though the claim of each be separate and distinct from those of all the others, unite in an equitable petition for the purpose of subjecting these corporators to individual liability, because of such misappropriation; and to the end of obtaining an accounting by them for the assets thus misappropriated, the corporation itself is a proper party co-defendant in such petition.[1] The United States Circuit Court of Appeals for the fifth circuit reversed a decree granting an injunction in the United States Circuit Court for the southern district of Georgia, and ordered the injunction dissolved upon a bill in equity seeking to subject the property of a railroad company to the payment of the simple contract debts of the complainants. In their bill they charged that the defendant railroad company was insolvent, and was about to put out an issue of second mortgage bonds for purposes and on a scheme that would work an injury to them as unsecured creditors, and asked for the appointment of a receiver and for an injunction. The Court of Appeals held that the Circuit Court had no jurisdiction of a bill in equity to subject the property of an insolvent corporation to the payment of a simple contract debt in advance of a recovery of a judgment at law, when such debt was unsecured by lien or mortgage, notwithstanding the statute of the state authorized the bringing of such suit by any three creditors of the insolvent corporation.[2]

removal of alleged liens or incumbrances upon property, the closing up of affairs of insolvent corporations, and the administration and distribution of trust funds are subjects over which courts of equity have general jurisdiction.' When insolvency proceedings may be instituted against an insolvent corporation, Marble *v.* Jamesville Mfg. Co.. (Mass.) 39 N. E. Rep. 998; Steel Edge Stamping & Retinning Co. *v.* Manchester Savings Bank, (Mass.) 39 N. E. Rep. 1021. Rules governing creditors' actions to enforce their rights against assets, etc., of insolvent corporations, see J. W. Butler Paper Co. *v.* Robbins, 151 Ill. 588; s. c., 38 N. E. Rep. 153; Moulton *v.* Connell-Hall-McLester Co., 93 Tenn. 377; s. c., 27 S. W. Rep. 672.

[1] Pullman *v.* Ellis, (Ga. 1895) 22 S. E. Rep. 568. As to the rights of a creditor whose execution against a corporation has been returned *nulla bona* to proceed by bill for a sequestration of the effects of a corporation, see Judson *v.* Rossie Galena Co., 9 Paige, 598. As to the proper mode in New York to obtain a sequestration of a corporation's assets, see Corning *v.* Mohawk Valley Insurance Co., 11 How. Pr. 190.

[2] Atlanta & Florida R. Co. *v.* Western Ry. Co. of Alabama, (1892) 50 Fed. Rep. 790. MCCORMICK, Circuit Judge, said: "The bill in [Terry *v.* Anderson,

§ 532. Claims against insolvent corporation — rules as to allowances, etc.— Upon the petition of certain banks which had made loans to a savings bank in Nebraska and held collaterals for their loans in insolvency proceedings against such savings bank, the questions to be decided were thus stated by the Nebraska Supreme Court: "Are these plaintiffs, the banks, entitled to have their claims against the general assets of the savings bank? And

95 U. S. 628, cited by appellee] was against the trustees and stockholders to enforce against the stockholders of the insolvent bank the liability of said stockholders for the unredeemed bills of the bank, some of which bills complainants held. Demurrers, not distinctly raising the question we are considering, were sustained, and the bill dismissed, and, in delivering the opinion of the court affirming the decree of the Circuit Court, Chief Justice WAITE says: 'The complainants are, neither of them, judgment creditors of the bank. In a suit instituted by the assignees to close up the assignment, they proved their claims, and the amount due them was found for the purposes of a division. The finding was sufficient for the purposes of distribution, but it has none of the characteristics of a judgment or decree, to be enforced as against anything but the fund which the court was then administering.' At a subsequent day of the term, in overruling a petition for rehearing, he used this language quoted in the brief of appellee's counsel: 'Ordinarily a creditor must put his demand into judgment against his debtor and exhaust his remedies at law, before he can proceed in equity to subject choses in action to its payment. To this rule there are, however, some exceptions, and we are not prepared to say that a creditor of a dissolved corporation may not, under certain circumstances, claim to be exempted from its operation. If he can, however, it is upon the ground that the assets of the corporation constitute a trust fund which will be administered by a court of equity, the principle being that equity will not permit a trust to fail for want of a trustee.' The case of Graham *v.* Railroad Co., 102 U. S. 148, cited by appellees, was a bill by judgment creditors of the railroad to subject certain lands alleged to have been fraudulently obtained from the railroad, to the payment of complainant's judgments. The bill was dismissed on demurrer. The question we are now considering was not in the case, and the concluding paragraph of Judge BRADLEY'S opinion, quoted by appellees' counsel, does not touch the question as to the appellees here being proper parties to bring the bill they have exhibited against appellants. Appellees' counsel quotes the second paragraph of the syllabus in the report of the case of Mellen *v.* Iron Works, 131 U. S. 353; s. c., 9 Sup. Ct. Rep. 781, which appears to sustain the contention of appellees. In the body of the opinion we note this language: 'It is, however, contended that the furnace company could not rightfully invoke the aid of a court of equity to remove this lien or incumbrance until it had, by obtaining judgment for its debt, and suing out execution, exhausted its legal remedies. Jones *v.* Green, 1 Wall. 330; Van Weel *v.* Winston, 115 U. S. 228, 245; s. c., 6 Sup. Ct. Rep. 22. But that was one of the questions necessary to be determined in the suit brought by that company, and any

if so, in what amount? For the whole original sum of the loans and interest, or must they deduct any and all sums collected of the collaterals, and prove their claim for the balance? And should a similar deduction be made before each dividend declared by the receiver? Each bank to receive, at each time the dividend is declared, only such amount as the balance remaining due it after such deduction entitles it? And if they are entitled to share in the general assets, should they be required, as a condition precedent thereto, to deliver the collaterals held by them to the receiver, to be by him collected or disposed of should the court so order, for the benefit of these banks, and applied on their claim until it is extinguished, or fully paid?" The court fully discussed the different rules which had been declared in different jurisdictions and adopted as in their judgment the proper one that all sums collected from the collaterals be deducted, and proof made for the balance of the claim, and, immediately before, or at the time of each dividend, all sums derived from the collaterals between the date of proof and the date of such dividend be deducted from the claim, and the creditor draw dividends according to the balance.[1] One holding claims against an insolvent corporation in the process of being wound up, partly secured by first

error in deciding it would not authorize even the same court in an original independent suit, to treat the decree as void. * * * In the view we take of the case, it is not necessary to determine the soundness of any of these propositions, for if the court erroneously ruled upon any of them, its decree could not, for that reason, be asserted in a collateral proceeding as void for want of jurisdiction.' And we take it that the Supreme Court, in this case, expressly did not decide the question we are now considering."

[1] State ex rel. Attorney-General *v.* Nebraska Savings Bank, (Neb. 1894) 58 N. W. Rep. 976. The court said: "We are satisfied that [the rule] is the true one, and that it will, in its present workings, result in keeping the parties in as near the exact relations they occupied, as to enforcement of their claims, before the appointment of the receiver, and in greater equity, fairness, equality, and justice than can be attained in any other manner, and hence we conclude to adopt it." As to the collaterals, it was then said: "What should be done with the collaterals has been variously determined by the courts which agreed on the main rule as to proof of the claim or claims, but we think the best and most equitable disposition that can be made of them is that they be delivered to the receiver, to be by him held and collected, or otherwise disposed of if the court so orders, and the amount realized in either manner, or both, if favored, to be applied by him to the payment of the debt due the banks until these sums, together with the dividend, result in canceling the indebtedness, or both funds are exhausted; the remainder, if any, then to be and become a part of the general assets, and for the benefit of all

mortgage on the property, and receiving an amount from the sale of the property of the corporation sufficient to pay the part secured by mortgage, the Illinois Supreme Court has held, was not entitled to be paid in the distribution dividends proportioned to the entire amount of his claims. The dividend should have been upon the residue of his claim.[1] It appearing that the notes of the corporation, which in this case was in the hands of a receiver as insolvent, were given payable at twelve months out of the first net earnings for a loan made to the corporation by its stockholders under an agreement between themselves to meet a certain indebtedness of the corporation, the corporation's liability on the notes was held to be limited to the net earnings, and, there being no net earnings applicable to the payment of the notes, there could be no recovery upon them either by the stockholders or those to whom they assigned them.[2]

§ 533. Rules in cases of insolvent banks.— Depositors in a bank which may be a state depository may set off their deposits against notes of theirs due the bank in the hands of a receiver of the bank. The lien of the state for the bank's indebtedness to it affects only the balances due on such notes after the set-off of the deposits due the makers.[3] A check on a suspended bank acquired

creditors; the expense of the collection of collaterals to be paid from such collections, and the general assets not to be chargeable with such expense; and no expense of collecting other assets to be paid from moneys derived from the collaterals; the receiver to be paid such compensation for holding the collaterals as shall be ordered by the court to be paid from the proceeds of the collaterals. By this we think the collaterals will be more rapidly made, and at less expense; and any favorable controversy between the receiver and the creditors holding the securities, in reference to it, or failure to collect or enforce it on their part, will be avoided." That a creditor cannot prove both his original claim and collateral obligations of the corporation creating a lien upon its property, see People v. Remington, 121 N. Y. 675, affg. 54 Hun, 480.

[1] First Nat. Bank of Peoria *v.* Commercial Nat. Bank of Peoria, (Ill. 1894) 37 N. E. Rep. 1019. The court distinguished, Re Bates, 118 Ill. 524; s. c., 9 N. E. Rep. 257. In Watson *v.* New Jersey Chemical Co., (N. J. Eq. 1894) 29 Atl. Rep. 186, Vice-Chancellor GREEN, a firm having transferred to a creditor, a claim against the corporation which subsequently had become insolvent, held that the dividend declared by the receiver should be applied on such indebtedness instead of on notes upon which the firm was accommodation indorser for the corporation.

[2] Lyman *v.* Northern Pac. Elevator Co., (1894) 62 Fed. Rep. 891.

[3] State *v.* Brobston, 94 Ga. 95; s. c., 21 S. E. Rep. 146. See Davis *v.* Manufacturing Co., 114 N. C. 321.

with a knowledge of its suspension by a debtor to that bank cannot be set off by him against his debt to the bank, though the check may have been acquired before a receiver for the bank was appointed.[1] A trust in favor of a principal will not be impressed upon the assets of an insolvent bank, giving him a preference over its other creditors by the simple fact that his agent deposited money in another than his own name with notice to the bank that it was the money of third parties.[2] Where a special depositor with a bank on being falsely told that there were not sufficient funds in bank to pay the amount held in trust by the bank for him, received in part payment a draft which was never paid, the Supreme Court of Michigan held that there was in the circumstances no waiver of his right to impress upon the assets of the insolvent bank a trust in his favor.[3] That a bank receiving money as agent for another, mingled it with its own funds, has been held in Michigan not to prevent the imposition of a trust for the amount on the insolvency of the bank, where the money in hand in the bank at the time prior to its failure was reduced below the amount in this manner received in trust by it.[4] A check given to the bondsman of a city treasurer by an insolvent bank for the amount of the first dividend on the claim of the city for a deposit of city funds by its treasurer was turned over to the city treasurer and credited on his account with the city. The Kansas Supreme Court has held that the amount of such check was a trust fund which might be recovered by the city from the assignee of the bank.[5] Where a holder of a bank certificate of deposit had become suspicious of the bank's solvency and withdrew a part of his deposit and took a certificate for the balance, upon an agreement that this balance should be put in a separate package, subject to his order, but it was not done, the Illinois Appellate Court held that this balance of money to his credit was not sufficiently distinct from the other funds of the bank to impress a trust in favor of the depositor on the insolvency of the bank.[6] The Supreme Court of Georgia has in a

[1] Avery *v.* Ladd, (Or.) 38 Pac. Rep. 1088.

[2] Henry *v.* Martin, 88 Wis. 367; s. c., 60 N. W. Rep. 263.

[3] In re Johnson, (Mich.) 61 N. W. Rep. 352.

[4] Ibid.

[5] City of Larned *v.* Jordan, (Kans.) 39 Pac. Rep. 1030.

[6] Bayor *v.* Schaffner & Co.'s Estate, 51 Ill. App. 180.

late case held that where a bank, having money on deposit with another, failed in business and became insolvent, being at the time indebted to the depositary upon promissory notes the sum total of which exceeded the amount of the deposit, it was the right of the depositary by way of equitable set-off to appropriate the money on deposit, as far as it would go, to the satisfaction of such notes, although they had not yet become due. In such case ordinary checks payable to the order of named persons drawn upon the depositary by the first bank before its failure, but not made payable specifically out of the fund on deposit, were neither assignments nor appropriations *pro tanto* of that fund, so as to bind the drawee to pay the same notwithstanding the drawer's failure. It was the right of the depositary after crediting the deposit upon the notes it held against the failing bank, to share upon the balance still due *pro rata* with the depositors of that bank in a general distribution of its assets in the hands of a receiver who had been appointed to take charge of and administer the same.[1]

[1] Georgia Seed Co. *v.* Talmadge, (Ga. 1895) 22 S. E. Rep. 1001. As to the point with reference to the checks upon the depositary not operating as an assignment, the court cited Baer *v.* English, 84 Ga. 403; s. c., 11 S. E. Rep. 453; Haas *v.* Bank, 91 Ga. 307; s. c., 18 S. E. Rep. 188; Jones *v.* Glover, 93 Ga. 484; s. c., 21 S. E. Rep. 50. As to the right of equitable set-off, see Kentucky Flour Co.'s Assignee *v.* Merchants' Nat. Bank, (Ky.) 13 S. W. Rep. 910; Nashville Trust Co. *v.* Fourth National Bank, (Tenn.) 18 S. W. Rep. 822; Jones *v.* Robinson, 26 Barb. 310. For a case holding that a county treasurer was not entitled to a preference over other creditors to certain moneys among the assets of an insolvent banker making an assignment for the benefit of his creditors, see Stevens *v.* Williams, (Wis. 1895) 64 N. W. Rep. 422. As to the right to recover from receivers of insolvent banks moneys received on deposit by banks with a knowledge of their insolvency, see Lake Erie & Western R. R. Co. *v.* Indianapolis Nat. Bank, 65 Fed. Rep. 690; Grant *v.* Walsh, 145 N. Y. 502; s. c., 40 N. E. Rep. 209; American Trust & Savings Bank *v.* Gueder & Paeschke Manufacturing Co., 150 Ill. 336; s. c., 37 N. E. Rep. 227, affirming 51 Ill. App. 349. As to rules governing in cases of criminal prosecution of officers of banks under statutes in various states for receiving deposits knowing the banks to be insolvent, see State *v.* Myers, 54 Kans. 206; s. c., 38 Pac. Rep. 296; Commonwealth *v.* Sponsler, 16 Pa. Co. Ct. Rep. 116; Carr *v.* State, (Ala.) 16 So. Rep. 150; Koetting *v.* State, 88 Wis. 502; s. c., 60 N. W. Rep. 822; State *v.* Buck, 120 Mo. 479. That the statute of Iowa as to criminal acts of officers of banks applies to officers of national banks, see State *v.* Fields, (Iowa) 62 N. W. Rep. 653.

As to "Insolvency of Private Corporations," see further, chapter XIII, "Insolvency of Banks," and chapter XIV, "Liability of Shareholders."

CHAPTER XXVIII.

FORECLOSURE OF MORTGAGES AND TRUST DEEDS.

§ 534. Jurisdiction of actions to foreclose.
535. Bringing such actions — rules.
536. Parties to such actions.
537. General rules as to such actions.
538. Decrees in such actions — general rules.
539. Decrees for sale of property.
§ 540. Purchasers at sales under the decrees — their rights and liabilities.
541. Who may be heard on petition in foreclosure suits.
542. Disposition in decree of proceeds of sale.
543. Allowances in forclosure suits

§ 534. Jurisdiction of actions to foreclose.— A federal court, having jurisdiction and possession, through its receiver, of all the property of a railroad company, thereby acquires jurisdiction of a subsequent suit to foreclose a mortgage on the same property, irrespective of the citizenship of the parties thereto, and may enter in such suit a binding decree of foreclosure and sale.[1] There is no jurisdiction or power in a state court to interfere with a decree of foreclosure made in a federal court against a railroad company where the railroad was within the jurisdiction of the court making the decree, and all the parties in interest were before it.[2] It has been held in the United States Circuit Court for the eastern district of Tennessee that the provision in the federal statute of August 13, 1888, that in any suit to enforce any legal or equitable lien on, or claim to, or to remove any lien or cloud upon, property situated in the district where the suit is brought, defendants who are not inhabitants thereof may be made parties, and brought into court by the methods there prescribed, applied to an original bill, brought for the purpose of enforcing various liens upon part of a railroad lying in the district, as against the lien of a general mortgage, which is about to be foreclosed in the same court by a suit ancillary to another suit in a different district and state. The court, therefore, held the original bill filed

[1] Carey *v.* Houston & Texas Cent. Ry. Co., (1892) 52 Fed. Rep. 671, following Morgan's L. & T. R. & S. S. Co. *v.* Texas Cent. Ry. Co., 137 U. S. 171; s. c., 11 Sup. Ct. Rep. 61.

[2] Gernsheim *v.* Olcott, (1889) 7 N. Y. Supp. 872. As to jurisdiction, see McBee *v.* Central Trust Co. of New York, 48 Fed. Rep. 243; affirmed by the U. S. Circuit Court of Appeals for the sixth circuit in McBee *v.* Central Trust Co. of New York, (1893) 57 Fed. Rep. 753.

by these lienors to be maintainable, although some of the defendants were non-residents of the district. The court's view of the matter was that while such a bill was an original bill within the meaning of that term as used in equity pleading, yet the suit in its essence was supplementary to the ancillary foreclosure suit which it sought to oppose, and hence the court's jurisdiction was unaffected by the fact that when the parties were arranged according to their interests in the suit, some who were residents of the same state would be found on opposite sides of the controversy.[1] A railroad company had been incorporated both in the state of Georgia and the state of South Carolina. The United States Circuit Court for the southern district of Georgia had appointed a receiver, and an ancillary suit was filed in the district of South Carolina to have his authority extended over the property of the company in that state. The complainant in the bill was a citizen of Georgia. Other citizens of Georgia were parties to the bill, which was the counterpart of the bill originally filed in Georgia, but no relief was asked against them. It was held upon a question of jurisdiction that the controversy was between citizens of different states, and the jurisdiction of the United States Circuit Court in South Carolina of the ancillary bill was maintained.[2] It appeared here that a railway company, the road of which passed through several states, purchased a small road lying entirely within one of the states. Afterwards it mortgaged the whole system, including the newly-purchased road. Several years afterwards there was brought in the Federal Circuit Court a suit to foreclose this general mortgage, and the whole property was placed in the hands of the receiver appointed in the federal court. The charter of this state road was, in the meantime, by proper proceedings in the state court, declared forfeited, and a receiver of its property appointed. Upon the petition of this state receiver to the federal court for possession, in which petition it was alleged that the sale of the road to the interstate company was *ultra vires* and void, and that, therefore, the federal court had no jurisdiction, it was held that this petition merely raised the question as

[1] McBee *v.* Marietta & N. G. Ry. Co., (1891) 48 Fed. Rep. 243.

[2] Phinizy *v.* Augusta & Knoxville R. Co., (1893) 56 Fed. Rep. 273. See as to the citizenship of the corporation, Shaw *v.* Mining Co., 145 U. S. 449; s. c., 12 Sup. Ct. Rep. 935; Railway Co. *v.* Whitton, 13 Wall. 283; Nashua & Lowell R. Corp. *v.* Boston & Lowell R. Corp., 136 U. S. 356; s. c., 10 Sup. Ct. Rep. 1004.

to the validity of the sale, which question could properly be tried in the federal court, and hence it would retain possession. Besides, the fact that the mortgagees of a prior mortgage, which was placed upon this state road before its order, had intervened in the federal court for the protection and enforcement of their prior lien, was also a sufficient ground for retaining jurisdiction and possession of the road. Nor did the fact that the state statutes provide for the payment of the corporation's debts after its charter is forfeited, and for the distribution of its assets, give the state courts exclusive jurisdiction, as these directions would be complied with in the federal courts.[1] In this suit for foreclosure in a state court of a corporation mortgage, one claiming the title to the property mortgaged by the corporation was made a party defendant; the claimant, as a non-resident, had the case removed to the federal court. In this court the case was ordered to be remanded on the ground that as in a suit for foreclosure only the rights and interests under the mortgage and subsequent to it could be determined, and that this third person who claimed a paramount and independent title was not a proper party to the suit, he should have applied to the state court where the foreclosure suit was proceeding for leave to bring an independent suit in that court against the receiver.[2] The following rules as to practice in foreclosure suits were declared in this case: A motion to consolidate three foreclosure suits when all are not ripe for decree, and where nothing can be gained for the purpose of a hearing, will be denied. Leave to file a cross-bill in a suit of foreclosure, where it appears that the purpose is to secure, between an alleged debtor and the mortgagor, an accounting not necessary to the determination of the suit, will be denied. Where a railroad is in the hands of receivers pending suits of foreclosure and settlement of the priority of liens, it is proper, on the application of a lienholder claiming priority, to extend the receivership as to such claim over the portion of the road on which the priority is claimed.[3] Here a mortgage bondholder sued for foreclosure in behalf of himself and all the other bondholders, and the other

[1] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1890) 48 Fed. Rep. 351.

[2] California Safe Deposit & Trust Co. *v.* Cheney Electric Light, Telephone & Power Co., (1893) 56 Fed. Rep. 257.

[3] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1889) 41 Fed. Rep. 8.

bondholders though not made parties, intervened by leave of the court, and prayed a foreclosure. It was held in the United States Circuit Court for the district of Washington that all such bondholders were indispensable parties, and in determining the jurisdiction of the court, they were all to be considered as parties plaintiff; and it having appeared that one of them was a citizen of the same state with several of the defendants, the jurisdiction of the federal courts failed.[1]

§ 535. Bringing such actions — rules. — A prior mortgagee cannot be required, against his will, at the instance of a subsequent mortgagee, to foreclose his mortgage.[2] In this case, the trust company, which was the trustee under a railroad mortgage, filed its bill in the United States Circuit Court for foreclosure of the mortgage as well as to set aside a sale of the railroad which had been made under a decree of the state court, in which proceedings it was charged there was fraud upon the part of the movers in the same. There being no averment in the bill that sixty per cent of the owners of the outstanding bonds had requested action on the part of the trustee, it was insisted that these proceedings were instituted without authority. The covenant in the mortgage upon which the contention was founded provided that in case of default, etc., in paying the interest and principal of the bonds, "it shall be the duty of the said trustees for the time being, and they shall or will, upon written request of the holders of sixty per centum of the said bonds then outstanding, enter upon and take possession of the said railroad property and estate," and operate the same, appropriating the net income to the best advantage, etc., "or the said trustee shall and will, after, or without entering upon or taking such possession, upon the written request of the holders of bonds of a like amount, proceed upon, and under this indenture of mortgage, to sell the railroad property and estate * * * at public sale in the city of Philadelphia, first giving at least four weeks' notice by publication, etc., and grant and convey the same to the purchaser, freed from all and every trust hereby created," etc. The

[1] Mangels *v.* Donau Brewing Co., (1892) 53 Fed. Rep. 513. See Removal Cases, 100 U. S. 468. The court distinguished Stewart *v.* Dunham, 115 U. S. 61; s. c., 5 Sup. Ct. Rep. 1163.

[2] Seibert *v.* Minneapolis & St. Louis Ry. Co., (1893) 52 Minn. 246; s. c., 53 N. W. Rep. 1151.

Supreme Court of the United States reversed the decree of the United States Circuit Court, dismissing this bill.[1] The court also held in this case that a provision in the railroad mortgage that the mode of sale provided by it "shall be exclusive of all others," was an attempt to provide against a remedy in the ordinary course of judicial proceedings and oust the jurisdiction of the

[1] Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & Melrose R. R. Co., (1891) 139 U. S. 137; s. c., 11 Sup. Ct. Rep. 512. Mr. Justice BROWN, speaking for the court, referred to the case of Chicago, etc., R. R. Co. *v.* Fosdick, 106 U. S. 47, 77, which was claimed to be decisive of the question of authority to bring the action, as follows: "In that case, which was a bill for foreclosure, the proviso was that the trustee, upon the written request of the holders of a majority of the bonds then outstanding, should proceed to collect both principal and interest of all such bonds outstanding, by foreclosure and sale of said property or otherwise, as therein provided. It was argued that the office of this clause was merely to make the obligation of the trustees imperative instead of optional, but the court held that the whole article must be taken together as a unit, and 'the nature of the provision and the character of its object must be taken into consideration as furnishing the rule of its interpretation.' It will be observed, however, that the provision was directed against the very proceeding taken by the trustees in the suit, namely, a foreclosure and sale of the property; while in the present case it is directed only to a taking possession or a sale *under the deed of trust* without institution of legal proceedings. A case nearer in point is that of Morgan's Steamship Co. *v.* Texas Central Railway, 137 U. S. 171, decided at the present term, in which the condition was that on default continuing for sixty days in the payment of interest or any part of principal, the principal of the bonds should become immediately due, and that upon request of seventy-five per cent of the holders of bonds and written notice of the same, the trustee should take possession of the property and operate it for the benefit of the bondholders, and that upon like request he should proceed to foreclose the mortgage and sell the property to the highest bidder for cash. It was also provided that nothing contained in the instrument should be construed to prevent or interfere with the foreclosure by any court of competent jurisdiction. It was held that the trustee could maintain a bill to foreclose the mortgage upon occurrence of a default without averring or proving a request of seventy-five per cent of the bondholders, as such request was necessary only in case the trustee wished to proceed to foreclose or take possession *ex mero motu* without the intervention of a court. We think that such limitations upon the power of the trustee to take legal proceedings to enforce payment of the amount secured should be strictly construed. In this case the condition only relates to the taking possession of the property under the deed of trust, or to a sale in the city of Philadelphia under the power of sale contained therein, and we think it should not be held to apply to foreclosure proceedings begun in a court of competent jurisdiction to obtain a judicial sale of the property. This was the ruling in the eighth circuit by Judge DILLON

courts, and was, therefore, invalid.[1] A mortgage of railroad property to a trustee to secure bonds and interest coupons, with provision that in case of demand and default of payment of interest for six months the trustee may enter upon the property, with a similar provision as to advertisement and sale, with an article besides stipulating that both of those remedies were cumulative of foreclosure proceedings in the courts which the trustee should institute at the direction of the bondholders "upon default being made as aforesaid," authorizes a bill to foreclose, although the default has not continued six months.[2] It was urged in abatement of this suit to foreclose a mortgage executed by a railroad company, that it was prematurely brought because default in the payment of interest had not continued for six months. The contention was based upon the language of the article in the trust deed which read as follows: "It shall be the duty of the trustee, upon a requisition in writing, signed by the holders of not less than one-quarter in amount of the said bonds then outstanding, and upon adequate security and indemnity against all costs, expenses and liabilities to be by the trustees incurred, to proceed to enforce the rights of the bondholders under this indenture, either by the exercise of the powers granted by articles 9 and 10 of this indenture, or of any of said powers, or by a suit or suits in equity or at law in aid of the execution of such powers,

in Alexander *v.* Central Railroad of Iowa, 3 Dill. 487, and by Judge CALDWELL in Credit Co. *v.* Arkansas Central Railroad Co., 15 Fed. Rep. 46, and we think it is sound. * * * Again, it is evident that this was a condition for the benefit of the grantor and its assigns, and that intervening lienholders and those who have purchased the property under decrees in their favor do not stand in a position to take advantage of this covenant. The whole object of the covenant was to protect the mortgagor against a seizure and sale of its property for non-payment of interest or principal at the mere caprice of the trustee, or without the consent of a majority of the stockholders, and it has no application to a case where the mortgagors have already lost the property under adverse proceedings instituted by parties having no connection with the mortgage."

[1] Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & Melrose R. R. Co., (1891) 139 U. S. 137; s. c., 11 Sup. Ct. Rep. 512; citing Hope *v.* International Society, 4 Ch. D. 327; Edwards *v.* Aberayron Ins. Society, 1 Q. B. D. 563; Horton *v.* Sayer, 4 H. & N. 643; Scott *v.* Avery, 8 Exch. 487; s. c., 5 H. L. Cas. 811; Thompson *v.* Charnock, 8 T. R. 139; Mitchell *v.* Harris, 2 Ves. Jun. 129; Tobey *v.* County of Bristol, 3 Story, 800; Noyes *v* Marsh, 123 Mass. 286; King *v.* Howard, 27 Mo. 21; Conner *v.* Drake, 1 Ohio St. 166; Trott *v.* City Ins. Co., 1 Cliff. 439; 2 Story Eq. § 1457.

[2] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1888) 36 Fed. Rep. 221.

or otherwise, as the trustee, being advised by counsel, shall deem most effectual to enforce such rights." Article 9 treated of the rights of the trustee to enter and operate the road in case of default in payment of interest continuing for six months. Article 10 treated of the rights of the trustee to enter and sell in case of default of the principal of the bond. The federal court held that the trustee was not deprived by the provisions of the right, in its discretion, to begin foreclosure proceedings immediately upon default in the payment of interest.[1]

§ 536. Parties to such actions.— The trustee named in a corporation mortgage or deed of trust, holding title for all the bondholders as beneficiaries, is the proper party to institute foreclosure proceedings, but in case of unreasonable neglect, or a refusal to discharge his duty, any bondholder may bring an action to enforce his security for the common benefit.[2] The United States Circuit

[1] Farmers' Loan & Trust Co. *v.* Chicago & Northern Pac. R. Co., (1894) 61 Fed. Rep. 543. JENKINS, Circuit Judge said: "This provision, as I conceive, has only reference to the exercise of the powers granted by articles 9 and 10, and to proceedings in aid of the execution of such powers. It is, moreover, mandatory, rendering action by the trustee imperative when the requisite number of bondholders shall require it, to act upon completion of the stipulated period of default. It does not interfere with the exercise of discretion of the trustee to act or limit its right to act immediately upon default. This view is strengthened by the subsequent provision declaring that the rights of entry and sale are granted or intended as cumulative remedies additional to all other remedies allowed by law, and that the same shall not be deemed in any manner whatsover to deprive the trustee or the beneficiaries under the trust of any legal or equitable remedy by judicial proceedings consistent with the provision of the trust deed. The subsequent provisions in prevention of suit by individual bondholders, without first giving notice in writing to the trustee of default continued for six months, and requesting it, to institute suit, are simply restraints upon the action of individual bondholders in supposed antagonism to the interests of the bondholders in a body. I think this case falls within the principle of Railroad Co. *v.* Fosdick, 106 U. S. 47; s. c., 1 Sup. Ct. Rep. 10; Morgan's L. & T. Railroad & Steamship Co. *v.* Texas Cent. Ry. Co., 137 U. S. 171; s. c., 11 Sup. Ct. Rep. 61; Farmers' Loan & Trust Co. *v.* Winona & S. W. Ry. Co., 59 Fed. Rep. 957. While it is true that a mortgagor has the right to stipulate for a breathing spell for the payment of his matured debt, it is still true that the limitations upon the powers of the trustee to take the legal proceedings to enforce payment upon default should be strictly construed. Guaranty Trust & Safe Deposit Co. *v.* Green Cove Springs & Win. R. Co., 139 U. S. 137; s. c., 11 Sup. Ct. Rep. 512."

[2] Seibert *v.* Minneapolis & St. Louis Ry. Co. (Griggs, Intervener), (1893)

Court of Appeals for the fifth circuit has held a foreclosure suit properly brought by one of three trustees named in the trust deed, where he averred that one of the other trustees was dead, and that the remaining one, who was made a defendant at a sale of the property covered by the trust deed under a decree of the state court, claimed to be interested in the purchase thereof, and was "interested adversely to the complainant as trustee of the bondholders."[1] They also held that the trustees, being empowered in this trust deed, on default of interest payments, to sell the property, "if, after notice is served on the president of said company, the same shall remain unpaid for six months after such default," having sued to foreclose, instead of selling under the power, it was unnecessary to aver the giving of notice of default to the president of the corporation.[2] The Supreme Court of New York, sitting in another department, having before it proceedings to declare the insolvency of and appoint a receiver for a trust company which had been named as trustee in a trust deed executed by a corporation to secure bonds which it had issued, upon motion of bondholders appointed another trust company trustee for the holders of said mortgage to fill the vacancy occasioned by the insolvency of the trustee first named, disabling it to act any longer in that capacity. This newly-appointed trustee brought action for foreclosure of the mortgage, and in the foreclosure action the legality of the appointment of the trustee to fill the vacancy was questioned, as not being within the terms of the provision as to filling such vacancy in the trust deed. The Supreme Court of New York, in General Term, held that the Supreme Court, succeeding to the jurisdiction and power of the old Court of Chancery, had jurisdiction of trusts and trustees, and had power, independent of any statute, to remove a trustee, on good cause shown, and to appoint another in his place; that the original trustee, under the trust deed, becoming insolvent, that court had jurisdiction to appoint a successor trustee. They further held that this trustee, having been accepted by the mortgagee and the bondholders as satisfactory, as evidenced by the action of

52 Minn. 148; s. c., 53 N. W. Rep. 1134.

[1] Alabama & Georgia Manufacturing Co. *v.* Robinson, (1893) 56 Fed. Rep. 690, affirming Robinson *v.* Alabama & Georgia Mfg. Co., (1891) 48 Fed. Rep. 12.

[2] Alabama & Georgia Manufacturing Co. *v.* Robinson, (1893) 56 Fed. Rep. 690.

those parties in the proceedings throughout, the mortgagee executing a supplemental mortgage to this trustee, and the bondholders placing their bonds under the control of the trustee, for receiving payments of interest, and for final action for foreclosure of mortgage, a stranger, not a trustee, could not raise any question as to the jurisdiction of the court appointing the successor trustee, or as to the regularity of the proceedings.[1] In this case the trust company, acting as trustee for bondholders under the mortgage, through its secretary, sent notice to the corporation mortgagor that it exercised the option given in the mortgage to declare the principal of the bonds due after the lapse of a fixed time in not relieving the default as to the payment of the interest. The Supreme Court of New York, in General Term, held that there was no necessity for a resolution of the directors of the trust company directing the secretary to take this action; that it was a matter that called for no deliberation or action upon the part of the directors; that it was a mere executive duty, which the executive officers of the trust company could perform in the ordinary discharge of their duty. It had been requested to take this action by the majority of the bondholders, and by the terms of the mortgage the request by the bondholders was conclusive and mandatory. Besides, the bringing of the suit of foreclosure was a sufficient declaration of the intention of the trustees to exercise the option.[2] The provision in a railroad mortgage that the trustees, after default and upon petition of the owners of a certain amount of the bonds, may take possession of and manage the road, or sell it, at their option, does not affect the right of the trustees as legal owners of the mortgage to go into a court of equity after default and ask the appointment of a receiver and foreclosure of the mortgage, without waiting for any action upon the part of the bondholders.[3] When a mortgage is made to a trustee to secure coupon bonds, the right to bring suit of foreclosure is in the trustee, which right,

[1] New York Security & Trust Co. *v.* Saratoga Gas & Electric Light Co., (1895) 34 N. Y. Supp. 890.

[2] Ibid.; citing Bank *v.* Kidder, 106 N. Y. 221; s. c., 12 N. E. Rep. 577.

[3] Phinizy *v.* Augusta & Knoxville R. Co., (1893) 56 Fed. Rep. 273. As to what provision in a mortgage for entry and possession by the trustee did not preclude the trustee from his regular action for foreclosure of mortgage for a default as to payment of interest, see Farmers' Loan & Trust Co. *v.* Winona & S. W. Ry. Co., (1893) 59 Fed. Rep. 957.

however, is not exclusive of the bondholders, unless made so by terms of the deed. And where a trustee in a mortgage securing coupon bonds accepts the position of trustee in a subsequent deed of general assignment made by the mortgagor for the benefit of all its creditors, which embraces the property covered by the mortgage, the respective interests to be represented by the trustee under the deed being conflicting and antagonistic, such acceptance on the part of the trustee would cause a forfeiture of any preference the trustee might otherwise have had, as against the bondholders, to bring suit to foreclose the mortgage.[1] The trust deed given to secure an issue of a New Jersey corporation's bonds, after conferring on the trustee a right to enter and hold possession, to sell, etc., declared that those remedies were merely cumulative, and additional to all other remedies allowed by law, and that the same should not be deemed to deprive the trustee, "or the beneficiaries under the deed," of any legal or equitable remedy. The whole series of bonds was to become due upon a default for six months in the payment of the interest. The mortgage was upon property of the corporation situated in Louisiana. A suit for foreclosure of this mortgage upon a default for the six months as to the interest was brought by a bondholder in the federal court for the eastern district of Louisiana. It was held, upon objection to the suit by a bondholder, that where the position of trustee was vacant, this owner of a majority of the bonds was entitled to maintain his suit in the federal court in his own name to foreclose the mortgage for himself and the other bondholders, and that the court would not compel him to go to New Jersey to have another trustee appointed.[2] Where there is a provision in a mortgage made to a trustee to secure coupon bonds that, in case of non-payment of any one of the bonds or coupons for thirty days after maturity, and payment demanded, it would be lawful for one-fifth or more of the holders of the bonds to cause the principal to be at once matured, and to call on the trustee to foreclose the mortgage, the bondholders alone are to exercise

[1] American Tube & Iron Co. *v.* Kentucky Southern Oil & Gas Co., (1892) 51 Fed. Rep. 826, overruling a demurrer to the bondholders' suit to foreclose.

[2] Wheelwright *v.* St. Louis, N. O. & O. Transportation Co., (1893) 56 Fed. Rep. 164. The court calls attention to Railroad Co. *v.* Orr, 18 Wall. 471, and Railroad Co. *v.* Fosdick, 106 U. S. 47; s. c., 1 Sup. Ct. Rep. 10, distinguishing them.

the option. The trustee need not join with them.[1] Where a mortgagor corporation and the trustee of the mortgage are citizens of the same state, the holders of bonds secured by the mortgage cannot bring suit in a federal court to foreclose the mortgage in their own name, without showing reasons why the suit is not brought by the trustee.[2] Mortgage bondholders, upon default in the payment of their bonds, may properly institute a foreclosure suit where a railroad company has been sued by a few minority stockholders, and a receiver asked, the suit being opposed by a great majority of the stockholders, and have a receiver appointed and thus control any litigation which might withdraw from the corporation the mortgaged property; and it would not be fraudulent or collusive for the officers of the corporation to admit the truth of the allegations in the bill filed by the bondholders. And a stockholder who has brought such a suit against the corporation cannot, by intervening in the bondholders' suit to foreclose, have such suit stayed until his suit is determined, unless the case be an extraordinary one, and such a proceeding be justified within sound judicial discretion.[3] The prayer of a petition of a committee representing bondholders under various mortgages of railroads, to be made a party plaintiff in a foreclosure suit where a receiver had been appointed for the property of a railroad company which owned or controlled a large number of other roads operated under separate charters, was denied in the United States Circuit Court for the eastern district of Virginia, the court holding that the fact that a single trust company was trustee under twelve different mortgages or trust deeds was not of itself a sufficient ground to support the petition, in the absence of anything showing negligence on the part of the trustee in protecting the interest of the bondholders or that there was any conflict between the various interests represented by the trustee.[4] One seeking to enforce by

[1] American Tube & Iron Co. *v.* Kentucky Southern Oil & Gas Co., (1892) 51 Fed. Rep. 826.

[2] Needham *v.* Wilson, (1891) 47 Fed. Rep. 97.

[3] Pennsylvania Co. for Insurance of Lives and for Granting Annuities *v.* Jacksonville, T. & K. W. Ry. Co. (American Construction Co., Intervener), (1893) 55 Fed. Rep. 131.

[4] Clyde *v.* Richmond & Danville R. Co., (1893) 55 Fed. Rep. 445. GOFF, Circuit Judge, said: "I think the rule is now well established that the individual bondholder and the separate beneficiary will not be made parties to suits relating to the mortgage or trust deed unless it is alleged and shown that the trustee is incompetent, or for some reason cannot faithfully repre-

suit a specific lien which does not involve the validity of a trust deed of a corporation, or affect its lien, when all the bondholders are before the court, and the joinder would oust the jurisdiction, need not join the trustee of the corporation trust deed or mortgage as a party defendant.[1] There was a petition in this suit to foreclose a railroad mortgage in which the petitioners prayed that they be allowed to be made parties defendant, alleging as a reason that the defendant company was made up by an illegal consolidation of three other companies, in one of which the petitioners were stockholders; that they never consented to, or recognized the validity of, the consolidation, and were not bound by it or by the act of the new company creating the mortgage; that the new company was "perhaps concluded by its conduct in the premises from making defense" to the suit; that the original company, of which they were stockholders, had no officer or representative upon whom they could call to make defenses for them, and that the counsel for the consolidated company declined to set up the defense which they desired to make. It was held by the United States Circuit Court for the northern district of Georgia that the facts stated in the petition gave no right to these petitioners to intervene as defendants, especially as there was no charge of fraud or collusion, and the proper remedy was by an independent suit.[2]

§ 537. General rules as to such actions.— In case the trustee in the junior of a series of mortgages pledging income of the railroad company and a stipulation in case of default in interest for the taking of possession of the property by the trustee, brings an action to foreclose his mortgage, making the prior mortgagees parties defendant, and obtains the appointment of a receiver to take possession of and operate the railroad and receive its earnings, the senior mortgagees may apply to the court to have the

sent the *cestui que trust*." The following cases will be found of interest upon this question: Skiddy *v.* Railroad Co., 3 Hughes, 320; Wetmore *v.* Railroad Co., 1 McCrary, 466; s. c., 3 Fed. Rep. 177; Railroad Co. *v.* Howard, 7 Wall. 392; Richter *v.* Jerome, 123 U. S. 233; s. c., 8 Sup. Ct. Rep. 106; Shaw *v.* Railroad Co., 5 Gray, 162; Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co., 53 Fed. Rep. 182; Van Vechten *v.* Terry, 2 Johns. Ch. 197; Kerrison *v.* Stewart, 93 U. S. 155; Richards *v.* Railroad Co., 1 Hughes, 28.

[1] Holly Mfg. Co. *v.* New Chester Water Co., (1891) 48 Fed. Rep. 879.

[2] Central Trust Co. of New York *v.* Marietta & N. G. R. Co., (1891) 48 Fed. Rep. 14.

receiver hold for and pay to them so much of the net earnings as is covered by their mortgages, and are, therefore, entitled to receive the same.[1] There was here a cross-bill filed by the trustees of a first consolidated railroad mortgage, after declaring the mortgage due before maturity for default in interest, pursuant to the

[1] Seibert *v.* Minneapolis & St. Louis Ry. Co., (1893) 52 Minn. 246; s. c., 53 N. W. Rep. 1151. The court said: "But suppose the case of an action to foreclose by a junior mortgagee, and appointment, upon his application, of a receiver to take possession of the property and receive the income for his benefit only, while there were senior mortgagees having the right to take and hold possession and receive such income, we can easily conceive that if they acquiesce in the possession of the property and the receipt of the income by the receiver for purposes other than their mortgages, making no move towards asserting their claims, they would have no right to any part of the income any more than had they permitted the mortgagor to remain in possession and to receive and disburse it for its general purposes. Such was the case of Sage *v.* Memphis & L. R. R. Co. 125 U. S. 361; s. c., 8 Sup. Ct. Rep. 887, in which the mortgagees had laid by until all the moneys they sought to have paid to them had been earned by the receiver, and he had been discharged. The purpose of that action was only to satisfy the plaintiff's claim, and for that purpose the receiver was appointed and the income was earned; but the purpose of this action is, in part at least, to adjust the rights of all the parties, as well to the income as to the body of the property. For the purpose of adjusting their rights to the income it was necessary for the court to lay hold upon, not merely that portion which the plaintiff might be entitled to, but that which all the parties were entitled to. The order appointing the receiver not assuming to appropriate it to plaintiff, the court was to be regarded as taking and holding it for all the parties, as their rights and interests might appear, at least so long as none of them made objection. * * * Being unable to take the possession from the mortgagor, or from the receiver, what then can [senior mortgagees of income] do, except, if they are not parties to the action, to come in by intervention, or, if they are parties, to petition the court that there be paid to them by the receiver out of the earnings which shall come into his hands such part as, but for his appointment, they would have had the right to receive and apply on their mortgages? The right of the prior mortgagees to take such a way to assert their claim, and subject the earnings to their lien, was recognized in the Sage case, the court saying: 'There was no moment pending the receivership when these parties, upon the request of the holders of a majority of the bonds, might not have appeared in this suit, or in a separate suit, in the same court, and asked that the receiver hold for them as well as Sage, or that he be discharged, and they be put into possession of the mortgaged property for the purpose of sale pursuant to the mortgage.' When such mortgagees are in the action, and so in a position to make their demand upon the court, it is entirely immaterial in what form it is made, so that it is clearly made, and presents to the court the ground of their claim, if it be not already before it."

terms of their mortgage in a pending foreclosure suit brought by second consolidated mortgage bondholders, which also prayed a foreclosure. Other lienors praying for a sale also came into the suit, their liens being prior to the first consolidated mortgage and past due. After this a cross-bill was filed by a majority of the holders of the bonds secured by the first consolidated mortgage, in which they repudiated the action of their trustees declaring the mortgage due, and prayed the court to order a sale subject to all incumbrances prior to the second consolidated mortgage, and to direct the payment out of the proceeds of all arrears of interest on the bonds secured by the first consolidated mortgage, and on certain mortgages prior to that, not offering, however, to bid an amount sufficient to pay these arrearages, or any of the large costs and expenses of the suit. The United States appellate court held that the Circuit Court rightfully refused to decree as requested in this cross-bill of the bondholders, and properly adhered to its determination to decree a sale free of all liens, reserving a right to any party to redeem on paying the several amounts found due, with costs.[1] There should be in a petition of junior lienors to be allowed to redeem prior mortgages, in foreclosure proceedings, an offer to pay whatever sums the junior lienors admit to be due. A prayer in such a petition that the prior mortgagees be required to deposit their securities in court in order that the petitioners "may have the privilege of redeeming" them has been held by the United States Court of Appeals to be insufficient.[2] A railroad company operated a road which with the property connected was located partly in the state of Ohio and partly in the state of Indiana. There had been a foreclosure of a mortgage upon this road and property in a state court of Ohio. A bondholder instituted his suit afterwards in the United States Circuit Court for the district of Indiana against the company and the trustee named in the mortgage, alleging that the trustee refused to bring action for foreclosure of the mortgage as against the property situated in that state. The decree in foreclosure in Ohio was pleaded in bar of the suit. The federal court held the plea insufficient, on the ground that under such circumstances a court of one state cannot merge into its judgment the lien on the property in the other state, and, while it may act upon

[1] Bound *v.* South Carolina Ry. Co., (1893) 58 Fed. Rep. 473.

[2] Ibid.

the person of defendant so as to compel it to make conveyances or releases, yet, if it had not done so, its mere judgment was not a bar to a suit in the other state between the same parties to foreclose the same mortgage there.[1] The trustees of railroad mortgage bondholders represent their bondholders in any litigation relating to the trust,

[1] Lynde *v.* Columbus, C. & I. C. Ry. Co., (1893) 57 Fed. Rep. 993. It was said in the opinion: "It is argued that, in respect of immovable property mortgaged by an interstate railway, a different rule has been established by the case of Muller *v.* Dows, 94 U. S. 444. It is contended that the court there held that as the railroad and its franchise were an entirety, any court having jurisdiction of the parties and subject-matter could make a valid decree of foreclosure which would operate on the entire railroad property as well without as within the state where the decree was procured, and that it would completely merge the lien of the mortgage. What was there said giving apparent support to this contention was merely *arguendo*, and was not essential to the judgment pronounced. In that case the Circuit Court of the United States for the district of Iowa passed a decree of foreclosure and sale of a railroad extending from a point in Iowa to a point in Missouri, and owned by a corporation formed by the consolidation of a corporation of Missouri with a corporation of Iowa. The entire line was covered by one trust deed, and the suit to foreclose was brought by the trustee. The mortgagees were also before the court, and the sale was made by a master at the instance of the trustee. It was held that the decree was not void so far as it directed the foreclosure and sale of that part of the railroad lying in Missouri, and that the trustee could be required by the court in Iowa to make a deed to the purchaser in confirmation of the sale. In my judgment this case does not overturn the well-established doctrine that a court in one state cannot pass a decree which shall operate to change the title to or merge a lien upon immovable property in another state. The title in that case was transferred by the court compelling the execution of a power of sale, and not by force of the decree. Mercantile Trust Co. *v.* Kanawha & O. Ry. Co., 39 Fed. Rep. 337; Farmers' Loan & Trust Co. *v.* Postal Telegraph Co., 55 Conn. 334; s. c., 11 Atl. Rep. 184. The case last cited is exactly in point. The Postal Telegraph Company, a New York corporation, mortgaged all its property, which was situated in several states, including Connecticut and New York, to the plaintiffs, in trust, to secure the payment of its bonds. Upon a failure to pay the interest the plaintiffs brought a suit for a foreclosure in the Supreme Court in the city of New York. Judgment was rendered for the plaintiffs, pursuant to which a referee was appointed, who sold all the property, including the real estate in Connecticut, and executed a conveyance of the same to the purchaser. Suit was brought to foreclose the mortgage on the Connecticut property according to the laws and practice in that state. The defendant, * * * an attaching creditor, appeared and set up a special defense, alleging the foreclosure and proceedings in the state of New York. The defense was held insufficient on the ground that the decree and proceedings had thereunder were nugatory as to the real estate situate in Connecticut."

and where the purpose of the suit is substantially the same as a foreclosure of the mortgage, the fact that the trustee is a party defendant instead of plaintiff is immaterial, and the bondholders are bound by the decree, although they may not be parties to the suit.[1] An intervening petition in proceedings to foreclose railroad mortgages, filed by one claiming under a contract for the purchase of land from the land agent of the company, where it appeared that the land in question, together with other lands, was specially excepted by the orders appointing the receiver from the property thereby put into his hands, and that he had never come into possession of the lands, and that in none of the several causes was there any controversy about the lands, nor any declaration of lien thereon in the respective decrees, and the intervener and the defendant company were citizens of the same state, was held by the United States Circuit Court to have been properly dismissed, both as thrusting a foreign litigation into the suit and for want of jurisdiction.[2]

[1] Pollitz *v.* Farmers' Loan & Trust Co., (1892) 53 Fed. Rep. 210. COXE, D. J., said: "In Shaw *v.* Railroad Co., 100 U. S. 605, the Supreme Court says: 'The trustee of a railroad mortgage represents the bondholders, and all legal proceedings carried on by him affecting his trust, to which they are not actual parties, and whatever binds him, if he acts in good faith, binds them. * * * The trustee represents the mortgage, and in executing his trust may exercise his own discretion within the scope of his powers.' In Beals *v.* Railroad Co., 133 U. S. 290; s. c., 10 Sup. Ct. Rep. 314, the court said: 'The former judgment was rendered by a court of competent jurisdiction, to which not only the railroad company that issued the bonds, but the surviving trustee under the mortgage made in the name of another company to secure the payment of those bonds, were made parties. The bondholders were thus fully represented in that suit, and bound by the decree canceling and annulling the bonds and mortgage, unless the decree was fraudulently obtained.' See, also, Kent *v.* Iron Co., 144 U. S. 75; s. c., 12 Sup. Ct. Rep. 650; Richter *v.* Jerome, 123 U. S. 233; s. c., 8 Sup. Ct. Rep. 106; Bank *v.* Shedd, 121 U. S. 74; s. c., 7 Sup. Ct. Rep. 807; Elwell *v.* Fosdick, 134 U. S. 500; s. c., 10 Sup. Ct. Rep. 598. These authorities, in my judgment, are conclusive."

[2] Cutting *v.* Florida Ry. & Nav. Co. (Wilson, Intervener), (1891) 45 Fed. Rep. 444. As to the right of the trustee to foreclose upon default in the payment of interest and to have a receiver appointed, see Mercantile Trust Co. *v.* Chicago, Peoria & St. Louis Ry. Co., (1893) 61 Fed. Rep. 372. That the provision in a mortgage for an entry by the trustee of the mortgage in case of default in interest for twelve months, will not prevent a foreclosure of the mortgage for interest past due, see Central Trust Co. *v.* New York City & Northern R. R. Co., 33 Hun, 513. When bondholders not wishing a foreclosure should be allowed to stop proceedings, see Tillinghast *v.* Troy & B. R. R. Co., 1 N. Y. Supp. 243. When the silence of bondholders may be considered equivalent to an assent to a foreclosure of a mortgage, see Barnes *v.* Chicago, Milwaukee, etc., Ry. Co., 122 U. S. 1.

§ 538. Decrees in such actions — general rules. — In a proper case, a court of equity has the power so to mould its decree as to order a sale of the mortgaged premises to satisfy that part of the mortgage debt which is due, and preserve the lien upon the mortgaged premises in the hands of the purchaser as to the unmatured part of the debt. In this case a railroad company negotiated its coupon bonds, secured by a mortgage upon its railroad, etc., each bond having an indorsement by another railroad company, binding it to purchase at maturity the bond and each interest coupon at par, "and, when so purchased, each and all of said bonds and coupons are to be held by the said company, with all the rights thereby given and with all the benefit of every security therefor." The guaranty company, having been obliged to purchase coupons, filed a bill before the maturity of the bonds. It was held by ACHESON, J., in the Circuit Court for the western district of Pennsylvania, that the contract of purchase must be so construed as to preserve to the bondholders their mortgage lien until the guaranty company should have fully performed its obligations according to the tenor of its indorsement, and that in the meantime its remedies upon purchased coupons must be kept within such limits as would effect that object. The court in the case, therefore, deeming it settled that the equities of all the parties in interest would be best subserved by a sale of the railroad, etc., under and subject to the lien of the mortgage securing the bondholders as to the principal of the bonds thereby secured, and the interest payable after the making of the sale, so decreed.[1] The United States Supreme Court has held that, where the report of a master in a suit in equity to foreclose a railroad mortgage to whom it had been referred to take proof of the claims, found as to a bondholder that his bonds were due and unpaid; that certain coupons had been paid, and that certain other subsequent coupons had been made, but made no mention of the intervening coupons, and no exception taken to the report, it was a reasonable inference that the bondholder did not offer these intervening coupons in proof, and that the failure to find as to them could not be urged as an objection to the final decree.[2] Where

[1] Pennsylvania R. Co. *v.* Allegheny Valley R. Co., (1891) 48 Fed. Rep. 139.

[2] Coghlan *v.* South Carolina R. R. Co., (1891) 142 U. S. 101; s. c., 12 Sup. Ct. Rep. 150.

a railroad has been mortgaged to secure bonds which have been guaranteed by the state, a decree that a certain branch of the road is not subject to the mortgage lien, is of no validity when made in a suit in which the bondholders are not represented, and of which the state has not been notified, and which is brought in a county in which no part of such branch road is situated.[1] Upon a motion to make absolute the order confirming the sale of railway property in this foreclosure suit, the United States Circuit Court for the southern district of Alabama held, upon the question of its jurisdiction to hear and decide this motion, that an appeal and supersedeas did not oust the jurisdiction of the lower court, or preclude collateral or independent proceedings, and that this court was not precluded by an appeal and supersedeas of a decree in respect to solicitors' fees in this foreclosure proceeding from passing on the question of confirmation of the sale made under that decree. There being an objection to confirmation of this sale, that the price was inadequate, it was held that inadequacy of price alone was not a ground to set aside a judicial sale, unless so great as to shock the conscience and excite the suspicion of the court; that an expression of a well-founded opinion by a witness, that the property would on resale bring a much higher price, was not sufficient ground for setting aside such a sale. And while inadequacy of price, accompanied by additional circumstances of unfairness, growing out of fraud, accident or some trust relation, are good grounds against confirmation, the fact that mortgage bondholders of the company were known to have authorized a committee to bid up to $400,000, and that the report deterred others from bidding, was not good ground for setting aside a sale of the property for $225,000 to the bondholders.[2] The creditors of a railroad company and the mortgagor company itself consenting to the entry of a decree of foreclosure of the mortgage and sale of the railroad, without fraud, in pursuance of a plan of reorganization, such a decree will not be set aside at the suit of some of the stockholders merely because the principal of one mortgage was not yet due, should it appear that the sums due for interest on that mortgage, for floating indebtedness, and on other mortgages then due are so great as to render fore-

[1] Central Trust Co. *v.* Florida Ry. & Nav. Co. (Hawkins, Intervener), (1890) 43 Fed. Rep. 751.

[2] Fidelity Trust & Safety Vault Co. *v.* Mobile Street Ry. Co., (1893) 54 Fed. Rep. 26. See Mining Co. *v.* Mason, 145 U. S. 349; s. c., 12 Sup. Ct. Rep. 887.

closure inevitable, and in that case to deprive the stockholders of all their equity in the property, especially when the shareholders do not offer to do equity by paying the floating debt and have not been diligent in attacking the plan of reorganization or in attacking the decree complained of.[1] It appeared here that this insolvent railroad company had issued several series of bonds secured by mortgages, some of which mortgages covered all of its property and others only part. The principal of some of the bonds was due, and the company had defaulted on the interest on all of them. In addition it had a large floating debt, running into millions. There was no fair possibility of its being able to pay the accrued interest on the bonds and the floating debt without sale of all its properties. Certain stockholders filed their bill to set aside a decree of foreclosure of the mortgages and to enjoin the defendants from carrying out the plan of reorganization. The United States Circuit Court held that this decree of foreclosure, entered by consent of the creditors, would not be set aside at this suit of the stockholders on the ground that the principal of some of the mortgages was not yet due, as it was to the interest of the railroad company that the rights of all the mortgage bondholders should be cut off to enable the company to effect a reorganization which would secure and extend its bonded debt and reduce the rate of interest thereon and provide the necessary means to satisfy the floating debt. Nor would a proposed reorganization of the company, to be effected in connection with the foreclosure sale, by which the bonded indebtedness was to be refunded on longer time and at reduced interest, and each stockholder being allowed to retain his stock on the payment of his *pro rata* share of the floating debt, it not being a fraud on the stockholders, be enjoined at the suit of some of the stockholders who did not suggest any other method by which the financial embarrassments of the company could be met.[2] A final decree for foreclosure of railroad mortgages directed that the property be sold subject to any and all liens prior to the lien of the mortgages, and which had not been ascertained and adjudicated, and subject to receivers' certificates before that time authorized, and declared the certificates a first and prior lien on the property as between them and the mortgagees. The sale having taken place under

[1] Carey *v.* Houston & Texas Central Ry. Co., (1892) 52 Fed. Rep. 671.

[2] Carey *v.* Houston & Texas Central Ry. Co., (1891) 45 Fed. Rep. 438.

this decree, a decree was made upon the intervening claim of a mechanic's lien on part of the property presented before the receivers' certificates were authorized, allowing the mechanic's lien as a subsisting first lien on the property and directing payment of the amount by the purchaser and, on default, a sale of the property. This decree was affirmed on appeal by the Supreme Court. A holder of receiver's certificates brought a suit against the holders of this mechanic's lien for an injunction to restrain the enforcement of this decree. The United States Circuit Court of Appeals for the fifth circuit held that the enforcement of the decree ordering payment of this mechanic's lien could not be restrained by holders of the receiver's certificates claiming privity over it, they being bound by the decree as privies, and because an injunction for such a purpose in effect stayed execution of the final decree of the Supreme Court.[1]

§ 539. Decrees for sale of property.— It is proper upon foreclosure of a mortgage upon the property of a manufacturing corporation, to direct that the property be sold as an entirety, where it appears that a division of it into parcels would lessen its selling value.[2] Creditors claiming to have prior rights to the property of an insolvent corporation have no right to complain of a decree for the sale of the property of the corporation to satisfy a mortgage where such decree expressly provides that such creditors may present their claims to the court for adjudication before distribution of the proceeds of the sale.[3] It appearing in a suit to foreclose a mortgage given by a street railroad company to secure payment of certain bonds, that the bonds were invalid, still, as all the property covered by the mortgage was in possession of a receiver appointed pending the litigation, who

[1] Gordon *v.* Newman, (1894) 62 Fed. Rep. 686. WHITE, Circuit Justice, said: "That the holders of receiver's certificates depend for their ultimate rank upon the final decree in the cause where the certificates are issued is beyond question." A text book thus states the rule: "The holders of these securities must see to it that in the order distributing the purchase money the proper provision is incorporated for their redemption, because, if once the property is sold, and the court makes a final decree without providing for the payment of the certificates, there is an end of the matter. * * *" Beach Rec. par. 401, p. 332; citing, also, Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co., 58 Fed. Rep. 11; s. c., 7 C. C. A. 3.

[2] Central Trust Co. of New York *v.* United States Rolling Stock Co., (1893) 56 Fed. Rep. 5.

[3] Ibid.

had issued certificates for expenses incurred for the preservation of the property, a decree was entered, upon consent of all parties in interest, ascertaining and fixing the amounts of their respective claims, and directing a sale of all the property of the company to satisfy the same. The court held that rails, fish plates and bolts purchased by the company for use on its road, but which had not been actually used and were stacked upon land not within the company's right of way, were within the terms of the mortgage, which included all real and personal property of every kind and description, "used or intended to be used in connection with or for the purpose of said railroad," and came clearly within the decree. In the receiver's inventory of property of the railway company taken possession of by him under order of the court were set out certain notes, secured by mortgage, which had been executed to the railway company by a land association, and these notes were in the receiver's hands at the time of making the decree by consent for the sale of all the company's property. The court held that, even though these notes and mortgages securing them were not included in the railway mortgage sought to be foreclosed, as they had been brought into the custody of the court under color of its authority, and all parties in interest were parties to the suit, the court had jurisdiction to decide all conflicting rights thereto, and should not release the control of them in order that they might be subjected to process obtained by creditors of the company from a state court, nor should it award such creditors a priority of lien by reason of their proceeding in the state court.[1] The railroad property in this foreclosure suit was ordered by decree of the court to be sold on the ground that most of the lienholders were urging a sale, and it appeared that, in spite of the exercise of ability and great economy by a receiver during the three years he had had it under his management, no interest had been paid on any of the securities for a year, although the sale was opposed by one class of bondholders.[2] An announcement at a judicial sale of the property of an insolvent corporation, by the receiver, that the purchaser would also have the right, at his election, to take certain land, not covered by the order of sale, and acquired by the

[1] Farmers' Loan & Trust Co. *v.* San Diego Street Car Co., (1892) 49 Fed. Rep. 188.

[2] Bound *v.* South Carolina Ry. Co., (1892) 50 Fed. Rep. 853.

receiver during his administration of the corporate property, has been held not to render such sale invalid. Nor was the mere fact that the receiver. on taking possession, inventoried the property at a sum considerably greater than that fixed by the appraisers at a judicial sale of the property eight years afterwards, a ground for setting aside the sale for inadequacy of price.[1] The railway company, the property of which was by this decree in foreclosure suit to be sold, being situated entirely within the state of Kentucky, there were assignments of error to the United States Circuit Court of Appeals for the sixth circuit that allowing four months by the decree for redemption was erroneous; that the railroad should have been treated as "realty," and the time allowed for redemption should have been that prescribed in the Kentucky statute where judicial sales are had and mortgages are foreclosed upon real estate. The appellate court held that the time to be allowed for payment of a railroad mortgage after the entry of a foreclosure decree was within the discretion of the court, and the allowance of only four months in this case was not an abuse of the court's discretion. Further, that when railroad franchises and property, both real and personal, are mortgaged, and are to be sold on foreclosure, they were to be treated as an entirety, and this entirety was not "real estate" within the meaning of the Kentucky statute which requires an appraisement as a prerequisite to a judicial sale of real estate, and allows one year for redemption when the property does not bring two-thirds of its appraised value.[2] The sale of the property in this foreclosure

[1] Lake Superior Iron Co. *v.* Brown, Bonnell & Co., (1890) 44 Fed. Rep. 539.

[2] Columbia Finance & Trust Co. *v.* Kentucky Union Ry. Co., (1894) 60 Fed. Rep. 794. LURTON, Circuit Judge, said: "A like question was decided by the Supreme Court of the United States in Hammock *v.* Trust Co., 105 U. S. 77. The question in that case arose under the redemption statutes of the state of Illinois. The statute of that state provided for the redemption of lands 'sold under and by virtue of any decree of a court of equity for a sale of mortgaged lands.' It was provided, with reference to the latter case, 'that it should be lawful for the mortgagor of such lands, his executors, administrators or grantees, to redeem the same in the manner prescribed for the redemption of lands sold upon execution upon judgments issued at common law.' Upon elaborate consideration it was unanimously decided by that court that a railroad was not within the provision of that statute. The learned counsel for the appellant have undertaken to draw a distinction between the state of the law of Kentucky and that of Illinois, which they have argued is sufficient to distinguish this case from the case of Hammock *v.* Trust Co., *supra*. These distinctions are predicated upon the propositions: (1) That under the law of Illinois a railroad property consisted in (a) its franchises; (b) its movable property, such as rolling stock, supplies, etc., which were under the common law personalty; (c) its right of way, to which was affixed its rails, bridges, culverts, depots, etc., and which was clearly real estate. The conclusion drawn from this common-law division of its property was commented on by the Supreme Court of the United States as fatal to the insistence that when a railroad was mortgaged as an entirety it was redeemable as 'real estate,' within the meaning of the Illinois statutes conferring the right of redemption when real estate was sold to enforce the lien of a mortgage, which, under the law, covered the franchises, personalty and realty as unitedly constituting a railroad. In contrast it has been insisted that, under the decisions of the highest court of Kentucky, at the time the mortgage to the Central Trust Company was executed in 1888: (a) A railroad was a unit, and that its movable property was so affixed to its real estate as to be held fixtures, and, therefore, inseparable. To support this proposition the cases of Phillips *v.* Winslow, 18 B. Mon. 448, and Railroad Co. *v.* Elizabethtown, 12 Bush, 233, are cited. (b) That, in harmony with this, the same court has held that railroad shares descend as realty to the heirs, and are subject to dower. Price *v.* Price's Heirs, 6 Dana, 107, and Copeland *v.* Copeland, 7 Bush, 349. (c) That the franchises of a railroad company are not prerogative franchises, and that a railroad could be operated without a franchise. Railroad Co. *v.* Metcalfe, 4 Metc. (Ky.) 199. The cases cited do not, in our judgment, support the conclusions sought to be drawn. Phillips *v.* Winslow, *supra*, was a case where a trustee under second mortgage, made to secure an issue of bonds, and covering all the property of the company then in existence, as well as all after-acquired property, filed a bill to enjoin certain proceedings at law by judgment creditors, one of whom had levied on certain movable property and was about to sell, while the other had seized and sold, and bought at his own sale, under execution, certain cars, car wheels, firewood and stove coal, being supplies for the operation of the road. The levy was exclusively upon property acquired after the mortgage under which the plaintiff claimed, but was embraced in the clause covering after-acquired property. After deciding that the property was not subject to seizure by execution, because it was embraced in the mortgage, the court was confronted with the proposition that the plaintiff had an ample remedy at law by replevin or in an action for damages. This the court decided upon a consideration of the irreparable character of the damage to creditors having a mortgage upon a railway by a unit which would result to them from such a seizure in view of the unity of railroad property, and other great inconveniences resulting to the public from the interference with the equipment and necessary supplies of a common carrier. The court did not decide that the rolling stock of a railroad passed with the realty as a fixture. It certainly did not decide that cordwood and stove coal were fixtures,

proceeding under the decree of the court was confirmed over the objection that it was sold at judicial sale as a whole, and not in the parcels in which it actually existed, and that either of such parcels was of sufficient value to discharge the lien for which the

whole was sold.[1] The court also considered the other objection to the confirmation of the sale, that other liens bore upon the same property of equal rank, and that the property ought to be resold, and for the benefit of all lienholders, as of no avail.[2] It is proper in a decree for sale on foreclosure proceedings against a railroad company upon a mortgage executed to secure its bondholders, the road being in the possession of a receiver, to direct that the sale be made subject to the standing obligations of the receiver, at the same time requiring the receiver to file a statement of his outstanding obligations in detail, so that the amount may be known with sufficient cer-

and yet the reasoning of the court was applied as much to such supplies as it was to the freight cars and detached car wheels, which were also in the levy. In the subsequent case of Railroad Co. *v.* Elizabethtown, *supra*, it was expressly ruled that a municipality could not dismember a railroad by a seizure for taxes of the engines and cars of a railway company. It is true that LINDSAY, C. J., did, in passing upon this question, observe that in Phillips *v.* Winslow, the engines and cars of a railroad 'were treated as fixtures.' But that case was not, as we have seen, put on any such ground, and indeed no such question arose for decision. Neither that case nor the decision in Railroad Co. *v.* Elizabethtown rested upon any technical consideration of the law of fixtures. The first went off, so far as the point now in question is concerned, upon the question of equitable remedy. The latter was vested [rested ?] upon the high and rational ground that a railroad was an entirety, and, being charged with *quasi* public duties as a common carrier, could not, from considerations of public policy, be disabled or dismembered by seizure under execution of its necessary equipments or supplies. It is true both cases recognized the unity of a railroad property resulting from its structure and utility. Severance of such a property is destructive of the interests of all concerned, and disables the road in the discharge of its public functions. Neither held that a railroad property considered as an entirety was technically realty."

[1] Central Trust Co. of New York *v.* Sheffield & Birmingham Coal, Iron & Ry. Co., (1894) 60 Fed. Rep. 9. PARDEE, Circuit Judge, said: "The answer to this objection is twofold: *First*, the decree so directed, and neither party complained until afterwards; *second*, there is no offer now by any one to pay a higher price for any parcel, or for the whole, than the sale realized, in case the bidding shall be reopened. * * * The decree is a sufficient answer, however, to the objection that the sale was not made in parcels. Hammock *v.* Trust Co., 105 U. S, 77–86; Central Trust Co. *v.* Wabash, etc., Ry. Co., 30 Fed. Rep. 332.

[2] Central Trust Co. of New York *v.* Sheffield & Birmingham Coal, Iron & Ry. Co., (1894) 60 Fed. Rep. 9. The circuit judge said: "The record of the cases discloses that there are other and large liens on the property of equal and perhaps prior rank to the intervener's lien. This, in part, accounts for the price brought at the sale, as the purchaser, as well as other bidders, knew that the property offered was incumbered. But such fact is no reason why the sale, as made, should not be confirmed, the other lienholders not complaining, and otherwise being able to take care of themselves."

[1] Bound *v.* South Carolina Ry. Co., (1893) 58 Fed. Rep. 473.

[2] Ibid.

[3] Bound *v.* South Carolina Ry. Co., (1893) 55 Fed. Rep. 186.

tainty to enable intending purchasers to bid with confidence.[1] The United States Circuit Court of Appeals for the fourth circuit has declared the following rules in a foreclosure proceeding participated in by different lienholders: The owner of second consolidated railroad mortgage bonds filed a foreclosure bill, and, according to the prayer of his bill, the court appointed a receiver and required all lienholders to come into the cause, and enjoined them from asserting their claims in any other case. Cross-bills were filed by all the lien claimants, including the holders of prior and subsequent mortgage bonds. These cross-bills asked affirmative relief and the sale of the property. For nearly three years the Circuit Court treated the suit as a consolidated case, and finally decreed a sale free of all liens. It was held by the Court of Appeals that it was too late for any party to object to the decree, that it was not in conformity to the prayer of he original bill, or to contend that because the lienors had filed cross-bills, instead of obtaining leave to file original bills, the pleadings were irregular.[2] A court of equity, pending an appeal, without supersedeas, from a final decree in a foreclosure suit, settling the priority of liens and fixing a day for sale, has power to postpone the order if a sale on the day fixed would be oppressive or unjust. And such a postponement should be made in such a suit to foreclose a matured mortgage, when an appeal has been taken from the decree of sale, the result of which might be disastrous to the purchaser, or where the sale, if incapable of being rescinded, would render nugatory a decision in favor of appellants.[3] In proceedings to foreclose the liens of the state of South Carolina on railway property as the guarantor of the railway bonds, as also the mortgages on the same property, the United States Circuit Court for that district refused to authorize the sale of land, free from such liens, at private sale, not being fully informed as to its selling value. In the opinion of the court, on foreclosure proceedings, where a receiver has been appointed, but the relative rights of the various parties had not been established, the fact that the mortgages authorized the sale of lands

not needed for corporate purposes, and the application of the proceeds by the trustees to the extinguishment of the oldest liens, would not justify such sale by the court, in the absence of consent by all the parties, and the mere absence of counsel from the hearing of a motion for the purpose of ordering such a sale would not amount to consent.[1] It is proper to order a sale of the property mortgaged, where shown to be in the best interests of all concerned, notwithstanding objections of a minority of the bondholders, when apparent that controverted questions of priorities and validity of some of the bonds can be afterwards settled.[2] The decree for sale of railroad property in foreclosure proceedings should name an upset price sufficiently large to cover claims against the proceeds of the sale.[3]

§ 540. Purchasers at sales under the decrees — their rights and liabilities.— Where a railroad has been in the hands of a receiver appointed by the United States Circuit Court, is sold, and the purchaser, as part of the consideration, covenants to discharge all existing debts and liabilities of the receivership, it is the duty of such court to protect the purchaser against all demands which are not just and proper demands against the receiver, and to that end to require all such demands to be presented to the court for allowance. And where, on the strength of such a covenant, a person brings an action in the state court against the purchaser to recover for a tort to his realty committed by the

[1] Bound *v.* South Carolina Ry. Co. (Mayfield, Intervener), (1891) 46 Fed. Rep. 315. See Kneeland *v.* Trust Co., 136 U. S. 89; s. c., 10 Sup. Ct. Rep. 950.

[2] First National Bank of Cleveland *v.* Shedd, 121 U. S. 74; s. c., 7 Sup. Ct. Rep. 807.

[3] Blair *v.* St. Louis, Hannibal, etc., R. R. Co., 25 Fed. Rep. 232. See, also, McIlhenny *v.* Binz, (Tex.) 13 S. W. Rep. 655. When a petition for an interlocutory decree of sale of railway property should be denied, see Pennsylvania R. Co. *v.* Alleghany Valley R. Co., 42 Fed. Rep. 82. When a court will not hear a motion in behalf of an individual bondholder to set aside a foreclosure sale under its decree, see Meyer *v.* Utah & Pleasant Valley R. R. Co., 3 Utah, 280. When an order of the sale of securities adjudged to be subject to the lien of a mortgage with the mortgaged property is conclusive, see Herring *v.* New York, Lake Erie, etc., R. R. Co., 105 N. Y. 340. When an order for sale of insolvent corporation's property granted to a receiver will not be vacated by the court, see Farmers' Co-operative Mfg. Co. *v.* Drake, (Ga. 1895) 22 S. E. Rep. 1004. What will be required to justify a reopening of the foreclosure proceedings where a sale has been decreed, see Leavenworth County *v.* Chicago, Rock Island, etc., Ry. Co., 25 Fed. Rep. 219. See, also, Robinson *v.* Iron Railway Co., 135 U. S. 522; s. c., 10 Sup. Ct. Rep. 907.

receiver, such demand being primarily chargeable on the fund in the federal court, arising from the sale of the railroad property, the federal court should restrain the prosecution of the action, and require the plaintiff to present his claim to it, inasmuch as a judgment on such a claim in the state court would entitle the plaintiff to satisfy it out of any property in the hands of the purchaser subject to levy; and the purchaser's appearance in the state court would not be a waiver of its rights to have the proceedings in the state court restrained, where the nature of the suit did not once appear, but it invoked the jurisdiction of the federal court as soon as its right to do so was revealed by the pleadings.[1] The federal court, in which, under foreclosure of a railroad mortgage there had been a sale, directed its receiver to turn over the possession of the road to another railroad company, the assignee of the purchaser at the sale, the court reserving the right to resume the possession if the assignee should thereafter refuse to pay into court any part of the purchase price. It was held, on an application of the assignee for a writ of assistance, that the order of the court just returned brought the assignee within Equity Rule 10, which provides that every person not a party to a cause, in whose favor an order has been made, shall be enabled to enforce obedience to such order by the same process as if he were a party to the same, and that a writ of assistance would issue in favor of such assignee against another railroad company which unlawfully refused to surrender possession of a part of the road.[2] It is a well-established principle that the mere purchase of a railway under a foreclosure sale by a new corporation does not of itself make such new corporation liable for the obligations of the old one.[3] In a case before the United States Supreme Court it appeared that a railroad company, which had purchased the property and franchises of a railroad company against which a mortgage had been foreclosed, neither renounced the contract under which the insolvent company had used the land constituting its approaches to a ferry belonging to a ferry company which by a contract with covenants on the part of the insolvent railroad company to use solely its ferry for the purposes of transportation of freight and passengers

[1] Jesup *v.* Wabash, St. L. & P. Ry. Co., (1890) 44 Fed. Rep. 663.

[2] Farmers' Loan & Trust Co. of New York *v.* Chicago & Atlantic Ry. Co., (1890) 44 Fed. Rep. 653.

[3] Stewart's Appeal, 72 Pa. St. 291; Vilas *v.* Milwaukee, etc., Railway, 17 Wis. 497; Smith *v.* Chicago & Northwestern Railway, 18 Wis. 17.

across this navigable stream, nor made any further arrangement with the ferry company after it became the purchaser. It maintained, however, possession of the land. The purchasing company becoming insolvent, and the mortgage it had executed being in the process of foreclosure, and the property in the hands of a receiver, the ferry company intervened and set up a claim on the theory mainly of the relation of landlord and tenant, for the use of its land, including, also, breaches of certain covenants as to using its ferry alone and not directing any of the traffic to other lines, as it charged had been done. The court regarded the theory of the intervention as a serious obstacle in the way of doing substantial justice between the parties, but recognized the right of the ferry company to equitable relief as against the purchasing company, as then represented by the receiver, and remanded the case to the Circuit Court for a change of pleadings and such further proceedings as might be consonant with justice and in conformity to its opinion.[1] A purchaser of a railroad at a foreclosure sale, who had no direct agency in the act complained of, will not ordinarily be liable for an act of the receivers operating the road prior to the sale; but if the act of the receivers created a nuisance, which was in existence at the time of the purchase, and the purchaser then had notice of the acts constituting the nuisance, and continued the nuisance afterwards, and in consequence thereof plaintiff's land was overflowed, rendered untillable, and his crops ruined, the Missouri Appellate Court held the purchaser to be liable.[2] They further held that written notice of the existence of a nuisance served upon the chief engineer of the former railway company could not import notice to a corporation (not then in existence) that subsequently purchased the railway at foreclosure sale; but where such officer was retained in the service of the receivers, and while so retained acquired full knowledge of all the facts constituting the nuisance, and the continuation thereof, and was continued in the office in the service of the subsequent purchaser, under such conditions as necessarily gave rise to the inference that such knowledge remained fixed in his memory when his employment by the purchaser began, then his knowledge must be deemed the knowledge of the purchaser. A purchaser at a foreclosure sale having been allowed in the

[1] Wiggins Ferry Co. *v.* Ohio & Mississippi Ry. Co., (1892) 142 U. S. 396.

[2] George *v.* Wabash Western Ry. Co., (1890) 40 Mo. App. 433.

decree confirming the sale a credit by reason of a certain receipt filed by him, the United States Circuit Court of Appeals for the fifth circuit held that it was error to reject such credit in the subsequent decree distributing the proceeds of sale.[1] The purchaser of this railroad property on foreclosure was entitled to a credit for taxes paid by it where the taxes were a lien upon the property, the date of the assessment not appearing, that being the date when the lien attaches under the statutes of Florida. The United States Circuit Court of Appeals for the fifth circuit held that it could not be said that the refusal to allow such a credit was error.[2] There being a provision in a railroad foreclosure decree that certain specified classes of claims constituted a lien prior to that of the mortgage bonds and a direction that the sale should be made subject to such lien, the purchaser at the sale would be estopped from objecting to the payment of a claim which belonged to one of the classes specified.[3] The mortgagor railroad company here, pending the foreclosure of a mortgage upon its property, etc., leased to another railroad company an equal right to the use of a designated part of the road for a period of twenty years. The foreclosure decree provided that the purchaser at the sale should be at liberty to abandon or disclaim any leasehold interest or contracts or other agreements entered into by the mortgagor after the commencement of foreclosure proceedings. The lessee railroad company declined to surrender the use it had acquired under this agreement with the mortgagor company to the assignee of the purchaser at the foreclosure sale upon various pretexts. The assignee applying to the court for a writ of assistance to enable it to secure the exclusive use of this part of the road purchased, it was held that the purchaser's right to abandon and disclaim the lease, as provided in the decree of sale, was not affected by the receipt of the rent by the receiver during the pendency of the foreclosure proceedings and his acquiescence in the lease, and that all right of possession in the lessee ceased on being notified of the purchaser's intention to disclaim and abandon. It appeared also that just after the foreclosure sale the assignee of the purchaser notified the lessee of its intention to disclaim the lease, and forbade the latter from using

[1] Cutting *v.* Tavares, O. & A. R. Co. (Florida Central & P. R. Co., Intervener), (1894) 61 Fed. Rep. 150.

[2] Ibid.

[3] St. Louis S. W. Ry. Co. *v.* Stark, (1893) 55 Fed. Rep. 758.

the road at the expiration of thirty days from the date of the notice. It was held by the court, upon the special contention of the lessee, that the receipt of the rent for those thirty days by the assignee of the purchaser, which was expressly stated to be without prejudice to its rights to abandon the lease, was not such a consent to the lessee's possession as to constitute it a tenant from year to year within the meaning of the Indiana Statutes, which provide that all general tenancies where premises are occupied with the consent, either express or constructive, of the landlord, shall be deemed tenancies from year to year, to be determined by three months' notice to be given the tenant before the expiration of the year.[1] Lands of a railroad company had been leased to one who built upon them warehouses, etc. There were provisions in the leases for the purchase of these improvements by the lessor or their removal by the lessee at the end of the term. These leases were made subsequent to the execution of mortgages by the railroad company and subject to them. In a bill filed by the final successor to the purchaser at foreclosure sale under the mortgages against the assignees of these leases to declare them void, a contention of the defendants was that the failure of the mortgagor to bring them in as parties defendant to the foreclosure suit operated as a recognition of their status as tenants and a ratification of their leases. The court held against this contention as the lessees were not necessary parties to that suit, and so far as the mortgagor was concerned, the rights of these lessees were extinguished by the foreclosure sale.[2]

§ 541. Who may be heard on petition in foreclosure suits.— Persons who are not parties to a suit cannot, in general,

[1] Farmers' Loan & Trust Co. of New York *v.* Chicago & Atlantic Ry. Co., (1890) 44 Fed. Rep. 653. And the undisputed facts showing that the purchaser, after the foreclosure sale, never waived its right to abandon and disclaim the lease, the federal court in which the mortgage was foreclosed, in the exercise of its primary jurisdiction over the matter, determined to issue a writ of assistance in favor of the purchaser, notwithstanding the issuance of a temporary injunction by the state court in which the purchaser appeared, restraining it from interfering with the lessee's possession, should the lessee continue to hold the property.

[2] Tyler *v.* Hamilton, (1894) 62 Fed. Rep 187. As to what passes by a sale under foreclosure of the property of the corporation, see Lawrence *v.* Morgan's La. & Tex. R. & Steamship Co., 39 La. Ann. 427; s. c., 2 So. Rep. 69; Dow *v.* Beidleman, (Ark.) 5 S. W. Rep. 297; Washington, Ohio & W. R. Co. *v.* Lewis, (Va.) 2 S. E. Rep. 746.

file a petition therein for any cause; but persons belonging to a class represented in the suit, such as mortgage creditors represented by the trustees of the mortgage, are regarded as *quasi* parties, and may be heard on petition or motion.[1] In suits brought by a trustee for foreclosure, or otherwise affecting trust property, the beneficiaries of the trust will frequently be allowed to intervene for the purpose of protecting their interest.[2] A petition seeking to recover damages from the trustee for maladministration of the trust cannot be filed as a cross-bill in a proceeding for the foreclosure of a deed of trust. The matter set up in such a bill is not necessary as a defense to the original bill, but would be matter entirely foreign to the primary object of the bill and would make it an original, independent bill.[3] In a foreclosure suit against a railroad company another railroad company intervened and petitioned the court to allow a claim which it made under certain traffic contracts entered into between several railroad companies. The petition was dismissed in the United States Circuit Court. The intervener appealed to the United States Circuit Court of Appeals for the eighth circuit and the appellate court affirmed the decree of the court below. It was held that such an agreement between railroad companies, by the terms of which all their roads were to be operated as to through traffic as if "operated by one corporation which owned all of them," and which provided for an actual division of such traffic, and, where this was not done, for a division of the gross earnings thereof, the obvious purpose of the agreement being to suppress or limit competition, and to establish rates without regard to their reasonableness, was contrary to public policy and void.[4] The appellate court further held in this case that one

[1] Fidelity Trust & Safety Vault Co. *v.* Mobile Street Ry. Co., (1893) 53 Fed. Rep. 850 (a bill to foreclose a mortgage). Citing Anderson *v.* Railroad Co., 2 Woods, 628.

[2] Fidelity Trust & Safety Vault Co. *v.* Mobile Street Ry. Co., (1893) 53 Fed. Rep. 850; citing Fost. Fed. Pr. 291; Carter *v.* City of New Orleans, 19 Fed. Rep. 659.

[3] Fidelity Trust & Safety Vault Co. *v.* Mobile Street Ry. Co., (1893) 53 Fed. Rep. 850.

[4] Chicago, M. & St. P. Ry. Co. *v.* Wabash, St. L. & P. Ry. Co., (1894) 61 Fed. Rep. 993. CALDWELL, Circuit Judge, said: "A railroad company is a *quasi* public corporation and owes certain duties to the public, among which are the duties to afford reasonable facilities for the transportation of persons and property and to charge only reasonable rates for such service. Any contract by which it disables itself from performing these duties, or which makes it to its interest not to perform, them or removes all incentive to their performance, is contrary to public policy and void." The court cited in support of its ruling Railroad

party to such illegal agreement, claiming to have performed its part of the same, could not maintain a suit to enforce division of earnings by another party thereto, the traffic not having been divided.[1] In this intervention in a foreclosure suit it was held not

Co. *v.* Closser, 126 Ind. 348; s. c., 26 N. E. Rep. 159; Gulf, C. & S. F. R. Co. *v.* State, (Tex.) 10 S. W. Rep. 81; State *v.* Standard Oil Co., (Ohio) 30 N. E. Rep. 279; Texas & P. Ry. Co. *v.* Southern Pac. Ry. Co., (La.) 6 So. Rep. 888; Gibbs *v.* Gas Co., 130 U. S. 396; s. c., 9 Sup. Ct. Rep. 553; Morris Run Coal Co. *v.* Barclay Coal Co., 68 Pa. St. 173; Salt Co. *v.* Guthrie, 35 Ohio St. 666; Stanton *v.* Allen, 5 Denio, 434; Hooker *v.* Vandewater, 4 Denio, 349; Chicago Gaslight & Coke Co. *v.* People's Gaslight & Coke Co., 121 Ill. 530; s. c., 13 N. E. Rep. 169; West Virginia Transp. Co. *v.* Ohio River Pipe Line Co., 22 W. Va. 600; W. U. Telegraph Co. *v.* American Union Tel. Co., 65 Ga. 160; Sayre *v.* Association, 1 Duv. 143; U. S. *v.* Trans-Missouri Freight Assn., 58 Fed. Rep. 58; s. c., 7 C. C. A. 15.

[1] Chicago, M. & St. P. Ry. Co. *v.* Wabash, St. L. & P. Ry. Co., (1894) 61 Fed. Rep. 993. CALDWELL, Circuit Judge, said: "The illegal and void contract has not been executed, and the appellant invokes the aid of the court to compel the Wabash Company to execute it on its part by pooling its earnings. It may be conceded that the illegal contract has been performed on the part of the appellant, though it does not appear to have done anything more than to sign the contract. The only thing it could do towards a performance of the contract was not to compete for the business. This was a violation of its duty to the public, and illegal. But a contract performed on one side only is not an executed contract. Where an illegal act is to be done and paid for, the contract is not executed until the act is done and paid for. A court will not compel the act to be done, even though it has been paid for. Neither will it compel payment, although the act has been done, for this would be to enforce the illegal contract. The illegality taints the entire contract, and neither of the parties to it can successfully make it the foundation of an action in a court of justice. The Wabash Company performed the service that earned the money the appellant is seeking to recover. The appellant earned no part of it. There is nothing in the record to show that the appellant would have carried more or the Wabash Company less freight if the contract had never been entered into. The money demanded was received by the Wabash Company for freight tendered to it by shippers themselves and carried by it over its own line. It was legally bound to accept the freight thus tendered, and was entitled to receive the compensation for the carriage, and cannot be compelled to pay the money they earned or any part of it to the appellant on this illegal and void contract. * * * Courts will not lend their aid to enforce the performance of a contract which is contrary to public policy or the law of the land, but will leave the parties in the plight their own illegal action has placed them. Central Transp. Co. *v.* Pullman's Palace Car Co., 139 U. S. 24; s. c., 11 Sup. Ct. Rep. 478; Gibbs *v.* Gas Co., 130 U. S. 396; s. c., 9 Sup. Ct. Rep. 553; Texas & P. Ry. Co. *v.* Southern Pac. Ry. Co., 41 La. Ann. 970; s. c., 6 So. Rep. 888; Morris Run Coal Co. *v.* Barclay Coal Co., 68 Pa. St. 173; Hooker *v.* Vandewater, 4 Denio, 349."

to be necessary, under the Missouri statute which gives a mechanic's lien for materials furnished to a railroad company, to show that the materials were incorporated in the construction of the road. Further, that the railroad, being in the hands of a receiver appointed by the court, he alone was a necessary defendant in an action to foreclose such a mechanic's lien under the statute which provides that any person or corporation "owning or operating" the railroad shall be made a party to such proceedings.[1]

§ 542. Disposition in decree of proceeds of sale.— The federal court for the eastern district of Missouri had under a judgment creditor's bill appointed a receiver and ordered the property of a railroad company sold. The property was sold subject to the lien of a mortgage covering its franchises, etc., to secure bonds and "to all liens for taxes." As to the distribution of the proceeds of the sale the court, inasmuch as the receiver had been in the possession of the property during the time when a levy might be made upon it for taxes on the personalty, ordered the payment of the taxes on personal property out of the proceeds of the sale in preference to all other claims; but as the state had a permanent lien for taxes on realty and the sale was subject thereto, did not order those taxes to be paid out of the proceeds. It was ruled further that the proceeds of the sale of the property being insufficient to pay the judgment creditors, and there having previously been no application to the payment of judgment creditors

The court disapproved Central Trust Co. *v.* Ohio Cent. R. Co., 23 Fed. Rep. 306, as not supported by authority and unsound in principle.

[1] Central Trust Co. of New York *v.* Chicago, K. & T. Ry. Co. (Holton-Warren Lumber Co., Intervener), (1893) 54 Fed. Rep. 598. PHILIPS, D. J., said: "Where, on petition of creditors, a court of chancery takes possession of a railroad, and appoints receivers to run and operate it, the property passes in *custodia legis*, and the receivers become the representatives of the corporation for the very purpose of protecting and preserving the property for the benefit of both creditors and stockholders. While the corporation, as a legal entity, is not disturbed, and its board of directors still exist, with power to guard and preserve the franchise, and would resume jurisdiction in management upon the surrender of the property by the court, yet they do not operate and control it while so in court, and I think the evident purpose of the statute * * * was to prevent the enforcement of such liens against the *corpus* of the corporation simply *in rem*. It seeks to have the railroad represented in court." When the petition of an intervening creditor should be dismissed, see Penn *v.* Calhoun, 121 U. S. 251.

of any of the railroad company's property which should have been applied to the payment of open accounts, the holders of such accounts were not entitled to participate in the proceeds of the sale. As to intervening judgment creditors, the rule was declared to be that the bill to reach the property which could not be effectively reached at law being filed by certain judgment creditors for the benefit of all judgment creditors of the insolvent railroad company, and no order having been made requiring others to intervene by a certain time or be barred of their rights, all judgment creditors who chose to intervene were entitled to share ratably with complainants in the proceeds of the sale of the property, even though some did not intervene until after the interlocutory decree ordering the sale; and the right of these subsequent interveners to share ratably was not affected by the fact that the bill prayed that after a sale the proceeds should be distributed among the persons in whose behalf the suit was brought "according to their respective rights and equities," as the original complainants and prior interveners had no prior lien on all the property sold when the bill was filed.[1] The decree of foreclosure in this case having provided, in accordance with the terms of the mortgage, that the purchase money should be applied "first to the payment in full, if it be sufficient, or, if not, to the payment *pro rata* of all defaulted coupons," the United States Circuit Court of Appeals for the fifth circuit held that a decree of distribution of the proceeds of the sale which directed a *pro rata* payment on the bonds themselves, before paying the interest coupons due, was erroneous.[2] A bill in equity to foreclose a railroad mortgage for non-payment of overdue interest, the principal being payable at a future day, was here taken *pro confesso*, the company appearing, but not answering. Under the decree of the court a sale was made, and, it appearing that there was a surplus over and above what was necessary to pay the overdue interest, costs and expenses, it was ordered by the court that this surplus be applied to the reduction of the principal sum due upon the bonds, and a decree entered that the balance of such principal sum remaining after the application of this surplus was due and payable from the company to the holders of the bonds, and that

[1] George *v.* St. Louis Cable & Western Ry. Co., (1890) 44 Fed. Rep. 117.

[2] Cutting *v.* Tavares, O. & A. R. Co. (Florida Cent. & P. R. Co., Intervener), (1894) 61 Fed. Rep. 150.

the trustee recover it for them, with interest until paid. The Supreme Court of the United States held that the application of this surplus was properly made, but the decree declaring the remainder of the principal due and immediately payable was irregular and was not warranted by the pleadings.[1] They declared in the same case these rules as to pleadings and appeals in such foreclosure suits: The defendant in a bill in equity, taken *pro confesso*, is not precluded from contesting the sufficiency of the bill or from insisting that the averments in it do not justify the decree. A decree on a bill taken *pro confesso* may be attacked on appeal, if not confined to the matter of the bill. The ninety-second rule in equity does not authorize a decree to be entered in a suit in equity for the foreclosure of a mortgage for a balance due to the complainant over and above the proceeds of the sale, if, as a matter of fact, such balance has not become payable. A railroad company, the road, property and franchises of which have been sold under a decree for the foreclosure of a mortgage entered on a bill taken *pro confesso*, may prosecute an appeal from the final decree distributing the proceeds of the sale and adjudging a balance still due the mortgage creditors.[2] This rule has been declared in the United States Circuit Court of Appeals for the eighth circuit: That the Circuit Court of Appeals cannot take knowledge, actual or judicial, of what may appear upon the records of the District and Circuit Courts within the boundaries of the judicial circuit, and to support the rights of appeal cannot assume the existence of necessary facts which do not appear of record in such courts. And upon an appeal from an allowance of a claim in railway mortgage foreclosure proceedings by one styling himself "the purchasing trustee of defendant's property," where it did not appear from the record that the property had been sold under the decree, or what interest or right appellant had in the proceedings, for whom he was trustee, or that the moneys out of which the claim was paid were a part of any fund in which he had an interest, the court held that the appeal should be dismissed, appellant not showing by the record any right to appeal.[3]

[1] Ohio Central R. R. Co. *v.* Central Trust Co. of New York, (1890) 133 U. S. 83.

[2] Ibid.

[3] Fitzgerald *v.* Evans, (1892) 49 Fed. Rep. 426. SHIRAS, J., speaking for the court, took occasion to say: "In view of the action we have felt com-

§ 543. Allowances in foreclosure suits.— Where there had been a foreclosure of a mortgage executed by a corporation for $145,000, and interest, a decree entered on default, and the property bought in by one of the bondholders for less than the mortgage debt, an allowance was made to the mortgagee, a trust company, of $1,000, and $500 allowed to its counsel. Upon exceptions to the master's report in this matter of allowances, it was held that no further allowance to the trustee for services or

pelled to take in this matter, we deem it advisable to call attention to the practice that should be followed in cases of railroad foreclosures, where a sale of the property is had before the rights of all intervening parties are determined, and where, by the terms of the decree, the court reserves full power to hear such matters after the sale, with the right to subject the property and its proceeds to the payment of claims finally adjudged to be prior to the lien of the mortgage. When a sale is made under a decree of the kind described, it is the duty of the purchaser, upon a confirmation of the sale, to make himself a party to the foreclosure proceedings by filing therein a supplemental bill or petition of intervention, setting forth the fact that he has, by purchase of the property, become a party in interest, thus showing that he has become subject to the burdens and entitled to the benefits of the decree under which he has purchased the property. Furthermore, if the purchaser does not reside within the territorial limits of the jurisdiction of the court, he should appear by an attorney who is a member of the bar of the court having charge of the foreclosure proceedings, so that when need arises the court may be enabled to have before it all persons interested in resisting the allowance or payment of claims which are asserted to be entitled to priority of payment. It not unfrequently happens that the purchasers at railway foreclosure sales may reside at distant points and without the jurisdiction of the court. If the purchaser who thus resides at a distance does not become a party to the record, and have an attorney representing him upon whom service may be made, the court and litigants are put to a great disadvantage in disposing of the claims asserted against the property or its proceeds. Many of the claims are of small amounts, and if, before the same can be allowed and paid, it is necessary to procure orders for service upon a purchaser living in New York or some other distant point, and to complete such service at his place of residence, the expense thereof will eat up the claim. It is due to the court and necessary for the prompt and inexpensive disposition of claims of the nature indicated, that the purchaser shall become a party to the record and subject himself to the jurisdiction of the court in the manner indicated. If the purchaser fails in this particular, then the court having jurisdiction of the foreclosure proceedings should, by appropriate action, compel the purchaser to become a party to the record in order that the business of winding up the foreclosure case and finally settling the rights of all interested may be proceeded with in an orderly way. If a purchaser at a foreclosure sale makes himself a party to the record in the manner indicated then it will be the duty of the Circuit Court to cause notice to be given him before passing upon inter-

counsel fees was warranted by the facts of the case.[1] It appeared here that on maturity of bonds secured by a railroad mortgage, after most of them had been returned and the holders of nearly all of the bonds outstanding had agreed to an extension of time, the trustee of the mortgage, on his motion, and without request by the bondholders, brought suit to foreclose. The suit was never prosecuted to a decree, proceedings on a second mortgage being afterward instituted in the federal court. Upon the petition by this trustee for allowances in the bondholder's suit to foreclose the second mortgage, SIMONTON, Circuit Judge, held that the suit by him was unnecessary and declined to allow him compensation or counsel fees. The lien of the first mortgage was not questioned in the foreclosure proceedings on the second mortgage; the holders of the bonds secured by the first mortgage had consented to an extension of time. The court held that the duty of the trustee, under the first mortgage, was to see that the amount due thereunder was determined, and a decree made concerning the interests of the bondholders; and for anything more than the performance of that duty he should not be allowed compensation

vening claims or directing their payment from the fund in court, and thus full opportunity will be afforded to all parties in interest to be heard for the protection of their rights." As to rules of distribution of proceeds of a foreclosure sale, see Pinkard *v.* Allen, 75 Ala 73. As to the rule of distribution of the proceeds of a sale where there is to be a distribution between bondholders secured by first and second mortgages, see Morton *v.* New Orleans & Selma Ry. Co., 79 Ala. 590. Rules as to the application of proceeds of sale to bonds purchased under an agreement of the company not to issue any more of that series. McMurray *v.* Moran, 134 U. S. 150; s. c., 10 Sup. Ct. Rep. 427.

[1] Boston Safe Deposit & Trust Co. *v.* Adrian, Mich., Water Works, (1891) 47 Fed. Rep. 8. SWAN, J., thus spoke of the principles governing such allowances: "While it is well settled that a trust fund is chargeable with the expenses of its own administration, and that counsel fees may be properly taxed against such a fund, the present is not a case calling for the application of that rule. Such allowances are frequently and properly made in cases where the trust fund had been rescued from waste or destruction arising from the fraud, neglect or misconduct of trustees, or when the energy and efforts of creditors or others interested have saved the property for those entitled. It is also true that a creditor primarily seeking satisfaction of his own debt, who has realized, by his diligence and at his own expense, a fund available for the benefit of others as well as himself, is entitled to reimbursement of his costs and expenses, either out of the fund or by a proportional contribution from those who accept the benefit of his efforts. The cases of Trustees *v.* Greenough, 105 U. S. 527; Railroad Co. *v.* Pettus, 113 U. S. 116; s. c., 5 Sup. Ct. Rep. 387; Hobbs *v.* McLean, 117 U. S. 567; s. c., 6 Sup. Ct. Rep. 870, afford examples of

or counsel fees.[1] As to allowances on foreclosure suits it was ruled in this case that an order might be made on the receivers for the payment of expenses incurred by a mortgagee in a suit of foreclosure, where the mortgage made provision for such expenses. But where the mortgaged property was insufficient to pay the mortgages, an order could not be made for allowance of counsel fees of the mortgagee to be paid out of money in the hands of the receivers.[2] The United States Circuit Court of Appeals for the fifth circuit has held, in the suit of a stockholder, in behalf of itself and other stockholders, should they come in, against a railway corporation, alleging the making of an illegal and void contract by the corporation, and praying for an account, an injunction, and the appointment of a receiver, an allowance for compensation to the complainant for solicitor's fees, pending an appeal from an order appointing a receiver and continuing a restraining order, to be premature.[3] In an action by the holder of second mortgage bonds of a railroad company for the appointment of a receiver, and a receiver was, therefore, appointed with the consent of all interested parties, and to the advantage of all, it was held that the services rendered by complainant's attorneys, being for the common benefit, should be paid for from the assets of the company.[4] This foreclosure suit was brought by a bondholder, who in his bill alleged *laches* on the part of the trustees of the mortgage, and made them, and all prior lienholders, parties. These prior lienholders, by cross-bills, also prayed foreclosure of their own liens, so that, as a result of the litigation, the property was decreed to be sold free of all liens. Upon a question of allowance of counsel fees, the federal court, by which the sale was decreed, held that the trustees of the various mortgages must be considered as acting in the interest of their own bondholders alone; and that the counsel fees of the various parties should not be charged upon the fund as a whole, but upon that part of the proceeds appropriated to the payment of the mortgages respectively. The court made this exception, and held that where part of the bondholders under a mortgage dissented from the action of their trustees in declaring the mortgage due for default in interest, and contested the matter in the foreclosure proceedings, such dissenting bondholders must pay their own counsel fees.[1] Certain bondholders appeared by their counsel, and contested the creditors' rights in a suit by bondholders to foreclose a mortgage of the corporate property and franchises, and took various steps during the progress of the case involving labor and responsibility on their counsel; subsequently, during the progress of the litigation, these contesting bondholders sold their bonds. On petition by their counsel to be allowed a fee payable out of the dividend which would go to these bondholders, it was held that the counsel had a lien upon such dividend, and that the purchaser of the bonds *pendente lite* took subject to this lien.[2] In a case where the complainant in a bill for the foreclosure of a railroad mortgage was the holder of a majority of the bonds secured by the mortgage, and the trustee, by agreement with the complainant, had declined to act in the foreclosure proceedings, and was made a co-defendant, full allowance having been made to the counsel of complainant and to the receiver for his services, all for duties which by the mortgage were assigned to the trustee, the United States Circuit Court held that it was not error to refuse an allowance also to trustee's counsel.[3]

the propriety of their allowances. In those cases costs and expenses were allowed the successful plaintiffs for the recovery of salvage of an imperiled fund, which, but for the diligence and activity of the creditor or trustee, would have been wholly lost to the beneficiaries or seriously depleted. They are marked, too, by the fact that success was only attained by long and laborious effort, and at great expense, against fraud, neglect, misconduct or vigorously contested hostile claims. It is just and equitable that such meritorious service should be adequately compensated by the parties benefited. No such features characterize this case." See, also, Williams *v.* Morgan, 111 U. S. 699; s. c., 4 Sup. Ct. Rep. 638.

[1] Bound *v.* South Carolina R. Co.; Ex parte Walker; Ex parte Calder, (1894) 62 Fed. Rep. 536.

[2] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1889) 41 Fed. Rep. 8.

[3] Jacksonville, T. & K. W. R. Co. *v.* American Construction Co., (1893) 57 Fed. Rep. 66.

[4] Bound *v.* South Carolina Ry. Co., (1890) 43 Fed. Rep. 404, ordering a payment to the attorneys on account as was done in Central Trust Co. *v.* Wabash, etc., Ry. Co., 23 Fed. Rep. 675.

[1] Bound *v.* South Carolina Ry. Co., (1894) 59 Fed. Rep. 509.

[2] Mahone *v.* Southern Tel. Co., (1887) 33 Fed. Rep. 702.

[3] Investment Co. of Philadelphia *v.* Ohio & Northwestern R. R. Co., (1891) 46 Fed. Rep. 696.

CHAPTER XXIX.

RECEIVERS IN FORECLOSURE SUITS.

§ 544. Receivers—their appointment — when they should be appointed — who may be appointed — their discharge and removal.
545. Conditions attached to the appointment of a receiver.
546. Receiver's right as to possession of the property of the insolvent corporation.
547. The relation of the receiver to property leased by the corporation coming into his hands.
548. Powers of receivers as to contracts, etc.
549. Power of the court and its receivers as to regulating wages of employees.
550. Receiver's certificates — when they will be authorized — the lien of such certificates and its enforcement.
551. Rules as to claims against receiver growing out of rolling stock coming into his possession.
552. Application of earnings of the road during receivership.
553. Jurisdiction of actions against receivers.
554. Claims against receivers for injuries to persons or property during receivership.
555. Rules as to actions for injuries to persons during receivership.
556. Rules as to allowances to receivers for counsel and expenses of parties in actions where receivers are appointed — what will be allowed and what not.
557. Actions allowed a receiver for the protection and benefit of the property in his hands.

§ 544. Receivers — their appointment — when they should be appointed — who may be appointed — their discharge and removal. — The appointment of a receiver has been held to be justified where it appeared that a railroad, heavily mortgaged, had made several defaults in the payment of interest, aggregating over $1,000,000; that the business was decreasing, with probability of further decrease from competition with new lines; that it was in need of repairs and improvements; that the bondholders were not in harmony; that a foreclosure was about to be decreed; and that no other way existed for applying the rents and profits of the road to its debts.[1] It appeared in this action, upon the foreclosure of a railroad mortgage and the appointment of a receiver, that the allegations of the bill and answer were in conflict as to the solvency of the company, the

[1] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1889) 36 Fed. Rep. 221. See Railroad Co. *v.* Cowdrey, 11 Wall. 463; Gilman *v.* Telegraph Co., 91 U. S. 603; Dow *v.* Railway Co., 124 U. S. 652; s. c., 8 Sup. Ct. Rep. 673; Kountze *v.* Hotel Co., 107 U. S. 378; s. c., 2 Sup. Ct. Rep. 911.

condition and care of its property, and the wisdom and economy of its methods of operation; but as it also appeared that a majority of the stock of the railroad company was in the hands of a construction company, with substantially the same officers as the railroad company, the officers of which construction company were adverse to those of the mortgage bondholders, and that the railroad company was unable or unwilling to pay the interest upon its bonds, a federal court held that a receiver should be appointed.[1] The allegations of a bill filed by a bondholder, to foreclose a railway mortgage and for the appointment of a receiver, that the railway company had made default in the payment of taxes lawfully levied and imposed upon the railway property, and that, in certain counties, it had permitted its railroad to be sold for such taxes; and, further, that the company was hopelessly insolvent, and unable to pay its present and accruing indebtedness, and that it had failed, neglected and refused to pay wages and operating expenses and other obligations and indebtedness, amounting to more than $200,000, and the further allegation that the bondholder, upon these facts coming to his knowledge, had applied to the trustee named in the mortgage to take action, and that the trustee had failed and neglected to take any steps, were held in a federal court to make a case for the appointment of a receiver.[2] In a case where the same receiver of a rail-

[1] Farmers' Loan & Trust Co. *v.* Winona & S. W. Ry. Co., (1893) 59 Fed. Rep. 957.

[2] Putnam *v.* Jacksonville, Louisville & St. Louis Ry. Co., (1893) 61 Fed. Rep. 440. Woods, Circuit Judge, said: "There is another phase of this growing indebtedness of the company in which the mortgagors or bondholders are interested. By the law as it has grown up under the case of Fosdick *v.* Schall, 99 U. S. 235, and later cases, establishing what is known in this circuit as the 'six months rule,' claims for labor and supplies, if not otherwise provided for, become entitled to preference over the mortgage debt. They, perhaps, do not constitute — I do not think they constitute — a lien on the property, such as to entitle the holders of them to apply for a receivership without first having established their demands. If such claims constituted a fixed or certain lien, their holders might be entitled to have receivers appointed to take care of their interests. But while there is not, strictly speaking, a lien, there is a preferential right which may be enforced against the mortgaged property if there be no other means of payment; and, consequently, to the extent that such demands are permitted to accumulate, the rights of the mortgagee are liable to be postponed. This bondholder, therefore, has a right to apprehend that his interest will suffer in that respect; and even if the delinquent taxes were paid, as it has been suggested they might be, that element of danger to his rights would not be eliminated.

road company had been appointed in an ancillary suit in one state, who had been appointed receiver in the original suit in another state, on principles of comity, there was a bill filed afterwards by the trustees under a mortgage to secure bonds issued by the railroad company for the appointment of a receiver, and for the foreclosure of the mortgage. It was shown in the United States Circuit Court for the district of South Carolina that the federal court in Georgia appointed its receiver at the instance of another railroad company that controlled the stock of the defendant company here, to further the interests of the dominant company's system, and not in the interest of creditors of the defendant company; and also that the federal court sitting in Georgia had since held that its action in the premises was unauthorized. The United States Circuit Court for the district of South Carolina held that, under these circumstances, a new receiver should be appointed, who could represent all interests, and whose position would be unassailable. Further, it was held that it was not necessary that the original receiver should be made a party to the trustee's bill, he being an officer of the court, and already within the jurisdiction and control of the court; nor was another corporation, against which charges were made, a necessary party, where no relief was asked against it.[1] A receiver having been appointed in a suit for foreclosure of a railroad mortgage, it has been held in Minnesota, constitutes no reason why a receiver should not be appointed in a proceeding by a judgment creditor of the railroad company under the laws of the state for the sequestration of all the property and effects of the corporation for the benefit of all its creditors.[2] There

I cannot escape the conviction that practically this road is insolvent, and to such a degree as to require the interference of this court."

[1] Phinizy *v.* Augusta & Knoxville R. Co., (1893) 56 Fed. Rep. 273.

[2] St. Louis Car Co. *v.* Stillwater Street Ry. Co., (1893) 53 Minn. 129; s. c., 54 N. W. Rep. 1064. It was said by the court: "The powers of the receivers in the two cases are entirely different. There are various classes of property that can be reached by a receiver under [the sequestration statutes] which could not be reached by a receiver appointed in a foreclosure suit. The former has substantially all the powers and functions of an assignee in bankruptcy. Everything becomes assets in his hands which are assets as to creditors, although not assets as to the corporation, as, for example, property conveyed in fraud of creditors, capital withdrawn without provision for the payment of corporate debts, the personal liability of stockholders, etc. Minnesota Thresher Mfg. Co. *v.* Langdon, 44 Minn. 37; s. c., 46 N. W. Rep. 310. Of course an appointment of a receiver under [this statute] would not necessarily supersede the receivership in the foreclosure suit. If the court should be of the opinion that the interests of the mortgagee could not be otherwise properly protected, both receiverships might coexist; that under [the statute] being subordinate, as to the property covered by the mortgage, to the receivership in the foreclosure suit. And as it would be eminently desirable, if possible, that the entire property should be under the control of an officer of the court, there would be nothing improper in the court appointing the same person receiver in both cases, provided there is no conflict of interest between the mortgagee and the other creditors of the defendant."

was in a case a question as to the propriety of the United States Circuit Court for the northern district of Ohio appointing receivers of the property located within that jurisdiction. The court ruled upon this point that where a railroad receivership had been extended by ancillary appointment over the property of the company in its jurisdiction, the court could not, even if it had the power, extend the receivership to, or appoint additional receivers in, another independent and original suit brought by the corporation which had leased its road to the insolvent company, upon unsupported allegations that the original receivership was brought about by fraud and collusion, and that the receivers were hostile to the lease.[1] In a late case, the federal

[1] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co., (1893) 58 Fed. Rep. 268. LURTON, Circuit Judge, said: "Whatever rights the complainant has as a creditor or under the lease it can set up as against the receivers without an extension of the receivership. Such extension would complicate accounts and result in conflicting directions. There are stronger reasons for the refusal to appoint additional receivers. The Erie system is a vast and extended one. Its lines extend into several states and as many different jurisdictions. The preservation of this system as a whole, its harmonious management as a unit, gives it its greatest value and power, and anything which tends to dismember it or to disrupt its management as an entirety should be avoided if possible. While it is a 'system' and while it remains a great 'trunk line' its management under order and direction of the court should be committed to one set of receivers having like authority in each jurisdiction and controlling each and every part of its property. Receivers are but officers and agents of the court. While necessarily much is committed to their judgment and discretion, yet their power depends upon the decrees and directions of the courts appointing them. Receiverships of railroads are in large part peculiar appointments. Railroads, as public carriers, are charged with great public duties, and the public are interested that their operation shall be continuous. Creditors are likewise interested that there shall be no cessation in their maintenance as going concerns, because their value as property depends upon the active use of the line. These considerations have developed the present well-settled proposition that such receivers are the mere custodians of the property, and hold

court for the eastern district of North Carolina, upon an intervention to rescind the order appointing the receiver of a railroad company, held that one possessing integrity of character, business experience, a capacity for the examination into and comprehension of accounts, who had had large financial experience and been concerned in the construction and management of railroads, with a knowledge of railroad accounts, was not disqualified to act as a receiver merely because he was not a railroad expert, acquainted with all the details of the mechanical work of a railroad plant. Neither should he be removed on the ground of alleged unfitness in removing the treasurer of the company and increasing the expenses of that office, of frequent visits in person on the railroad and extravagant expenditures, nothing being shown as to the ability of the person discharged, and the receiver's answer showing that the expenses of the treasurer's office had not been increased beyond what the pecuniary situation warranted; and the allegations of visits were positively denied by him, and no extravagant expenditure having been shown. Further, there was no disqualification of a person to act as receiver of a North Carolina corporation, owing its conception to the citizens of that state, merely because he was not a citizen of North Carolina.[1] In proceedings for the appointment of a receiver of an insolvent railroad company, one who is a party to or counsel in the cause,

for and as mere agents of the court. Speaking of the character of such trustees and the effect of such holding upon the interests procuring the appointment, Chief Justice WAITE said: 'The possession taken by the receiver is only that of the court, whose officer he is, and adds nothing to the previously existing title of the mortgagee. He holds pending the litigation, for the benefit of whomsoever in the end it shal be found to concern, and in the meantime the court proceeds to determine the rights of the parties upon the same principles it would if no change of possession had taken place.' Fosdick *v.* Schall, 99 U. S. 235, 251; Railroad Co. *v.* Humphreys, 145 U. S. 82; s. c., 12 Sup. Ct. Rep. 787. A receiver represents no particular interest or class of interests. He holds for the benefit of all who may ultimately show an interest in the property. He stands no more for the creditor than the owner. They are not assignees, and the principles of common law applicable to assignees do not define or determine the character of a receiver's possession or its effect upon the rights of those interested in the property in their possession. Receivers ought not to be appointed to represent the peculiar interests of one class, and, *a fortiori*, they should not be appointed to represent one interest out of a class of interests."

[1] Farmers' Loan & Trust Co. *v.* Cape Fear & Y. Val. R. Co., (North State Imp. Co., Intervener) 62 Fed. Rep. 675, confirming the appointment.

or who has been an officer of the company, will not be made the permanent receiver.[1] A United States circuit judge has authority to hear at chambers a motion to discharge a receiver of a corporation.[2] A federal court, which had been petitioned to remove a receiver of a railroad, has recently declared this rule of practice in such matters as a proper one. In general, the party who asks the court to remove one of its officers for malfeasance or incompetency should be prepared, not only to prefer specific charges of wrongdoing, but to accompany them with proof. It ought not to be tolerated that, upon mere vague and unsupported charges, one should be compelled to submit to a sweeping investigation into his conduct, and that upon such charges a court could properly be asked to order a general investigation into his conduct, and that upon such charges a court could properly be asked to order a general investigation to ascertain whether something might not be found objectionable to his standing. It is a fundamental and most just principle of law that one should not be put to answer vague and indefinite charges. Nor, in general, as to a specific charge of malfeasance, should one be put to his defense, in the absence of evidence tending to sustain the charge. In this particular case, the receiver objected to had been appointed at the request of the trustees in all but one of the mortgages on the railway, and on the recommendation of the bondholders secured by the mortgages, with the express assent of the railroad company, in the service of which he had been for many years as general manager of the railroad, and as director, vice-president and president. He was thoroughly familiar with its history, conditions and necessities, and was a thoroughly competent railroad manager. The proofs established that the road had been managed with prudence and economy, so far as concerned its actual operation, and no fault in the management of the property was

[1] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co., (1891) 45 Fed. Rep. 436.

[2] Walters *v.* Anglo-American Mortgage & Trust Co., (1892) 50 Fed. Rep. 316. CALDWELL, Circuit Judge, said: "The exercise of chambers jurisdiction in equity cases is absolutely essential for the purpose of preventing the delay, injustice, expense and inconvenience which must inevitably ensue if applications for relief had to be made in all cases to the court in session. A motion to discharge a receiver may be heard at chambers, upon direction, and will be granted when it appears that he was improvidently appointed, or that there is any other sufficient reason for his discharge. Railroad Co. *v.* Sloan, 31 Ohio St. 1; Crawford *v.* Ross, 39 Ga. 44; Beach on Rec. § 778.

suggested. The court declined to remove the receiver against whom the petition was directed, holding the fact that he was an officer and director of the company at the time of his appointment not to be a ground for a revocation of his appointment.[1] Bond, Circuit Judge, in the United States Circuit Court for the district of Maryland, while recognizing that the suggestions and recommendations of persons who substantially own property about to be intrusted to a receiver are of great weight with the court in making an appointment of a receiver, declined to remove this receiver of railway property, whose management had been able, efficient and impartial, at the request of the controlling stockholder and his associates, in a case where the litigation was not for the purpose of foreclosing a mortgage, but was instituted by a minority stockholder on the ground that the bonded indebtedness and the issues of stock were being vastly increased without any corresponding increase of assets, and mainly for the benefit of the controlling stockholder.[2] The removal or appointment of a receiver rests in the sound discretion of the court making the order, and is not reviewable in the Supreme Court of the United States.[3] A court of equity appointing receivers for a corporation, in case the parties interested fail to provide means for the discharge of such receivers within a reasonable time, will, on its own motion, consider the propriety of dissolving the receivership.[4]

[1] Farmers' Loan & Trust Co. *v.* Northern Pacific R. Co., (1894) 61 Fed. Rep. 546.

[2] Street *v.* Maryland Cent. Ry. Co., (1893) 58 Fed. Rep. 47.

[3] Milwaukee & Minnesota Railroad Co. *v.* Soutter, 154 U. S. 540; followed in Milwaukee & Minnesota Railroad Co. *v.* Soutter, 154 U. S. 541.

[4] Platt *v.* Philadelphia & Reading R. R. Co., 65 Fed. Rep. 872. Who should be appointed receivers, see Olmstead *v.* Distilling & Cattle Feeding Co., 67 Fed. Rep. 24; Ralston *v.* Washington & C. R. Ry. Co., 65 Fed. Rep. 557. When receivers will or will not be removed, see Etowah Mining Company *v.* Wills Valley Mining & Mfg. Co., (Ala.) 17 So. Rep. 523; Gypsum Plaster & Stucco Co. *v.* Adsit, (Mich.) 63 N. W. Rep. 518; Fowler *v.* Jarvis-Conklin Mortgage Trust Co., 66 Fed. Rep. 14. In Clap *v.* Interstate Street Ry. Co., (1894) 61 Fed. Rep. 537, Colt, Circuit Judge, denied a petition to appoint a separate receiver for one of the railway company's branches, such branch having ceased to be operated by reason of the destruction of its power house. He said: "If the road were running the court might, upon the showing made by the petitioners, direct the receiver to keep a separate account of the receipts and disbursements of [the branch road], but in the present condition of affairs, I see no necessity for making any such order. The burning of the power house has stopped the running of cars, much to the inconvenience of the public. If this had not happened, the effort might have been made to continue the road in operation while it remained in the hands of the court; but as this cannot be done, owing to this accident, I hardly think it within the legitimate powers of the court for it to undertake to set the road in operation again by the outlay of any considerable sum of money unless it should be requested so to do by all the parties in interest. It is not the business of the court to build railroads or to set railroads in operation which have ceased to run, but its duty is to preserve the property which comes into its hands until it passes to the rightful owners, and, incidentally, in furtherance of this end, to continue the operation of the railroad where it is practicable."

§ 545. Conditions attached to the appointment of a receiver.— The doctrine of the United States Supreme Court is that a court of equity may make it a condition of the issue of an order for the appointment of a receiver that certain outstanding debts of the company shall be paid from the income that may be collected by the receiver or from the proceeds of sale; that the property being in the hands of the court for administration as a trust fund for the payment of incumbrances, the court, in putting it in condition for sale, may, if needed, recognize the claims of materialmen and laborers, and some few others of similar nature, accruing for a brief period prior to its intervention, where current earnings have been used by the company to pay mortgage debts or improve the property, instead of to pay current expenses, under circumstances raising an equity for their restoration; as, for instance, where the company, being insolvent and in default, is allowed by the mortgage bondholders to remain in possession and operate the road long after that default has become notorious, or where the company has been suddenly deprived of the control of its property, and the pursuit of any other course might tend to cessation of operation.[1] The better practice, it has been held, when a receiver has been appointed for a railroad, is for the judge of the court making the appointment to stipulate at the time, and as a condition of the appointment of a receiver, what debts and liabilities of the railway company shall be made a charge on the property and paid by the receivers. If the mortgagee is unwilling to take a receiver on the terms pro-

[1] Fosdick *v.* Schall, 99 U. S. 235; Miltenberger *v.* Logansport Railway, 106 U. S. 286, 311, 312; Penn *v.* Calhoun, 121 U. S. 251; Blair *v.* St. Louis, etc., R. R. Co., 22 Fed. Rep. 474; Farmers' Loan & Trust Co. *v.* Vicksburgh, etc., R. R. Co., 33 Fed. Rep. 778.

posed, the foreclosure can proceed without a receivership. If no order is made when the receiver is appointed, it can be made afterwards.[1]

§ 546. Receiver's right as to possession of the property of the insolvent corporation.— A court will protect its receiver in the possession and proper use and management of the property and privileges pertaining thereto committed to him. And it will extend such protection even to restraining another railroad company from proceeding to condemn, or to subject to its use, property in the possession of its receiver by proper legal proceedings, and will more readily do so when such condemnation or vice is sought or attempted to be had without any legal proceedings being taken for that purpose. In this case the court granted an injunction restraining a street railway company, its officers, servants and agents, from entering with their track upon, or in any manner interfering with, the right of way and roadbed of the street railroad as then possessed, used and operated by the receiver appointed by that court. At the same time the court refused to consider, at the instance of its receiver, who did not use electricity in his management of the street railroad in his

[1] Central Trust Co. *v.* St. Louis, A. & T. Ry. Co., (1890) 41 Fed. Rep. 551; Fosdick *v.* Schall, 99 U. S. 235; Blair *v.* Railroad Co., 22 Fed. Rep. 471. In Farmers' Loan & Trust Co. *v.* Kansas City, W. & N. W. R. Co., (1892) 53 Fed. Rep. 182, it appeared that there were many creditors entitled under the laws of Kansas to liens on the property, or parts of, it and also other creditors who had the right to subject the income and earnings of the road to the payment of their claims. The court required the trustee, as a condition of appointing the receiver, to assent to the payment of all their claims prior to the satisfaction of the bonds, and the decree appointing the receiver provided for the payment of all debts for ticket and freight balances, for work, labor, materials, machinery, fixtures and supplies of every kind and character furnished in the construction, extension, repair, equipment or operation of the road, and all liabilities incurred in the transportation of freight and passengers, including damage to person and property, which had accrued since the execution of the mortgage, CALDWELL, Circuit Judge, in the United States Circuit Court for the district of Kansas, held, that imposing this condition upon the appointment of the receiver was a proper exercise of the court's discretion to impose terms; and that the trustee's assent thereto was binding upon the bondholders, and the bondholders would not be permitted to become parties to the suit for the purpose of having this decree vacated. There is a very interesting and full note to this case on the foreclosure of railroad mortgages and matters pertaining to such suits in 53 Fed. Rep. 192, by Morris M. Cohn, of Little Rock, Ark.

possession, how the use of electricity by a competing company over five blocks of the same roadbed might affect future purchasers, should they desire to introduce that motive power.[1] The property of the railroad company involved in this foreclosure suit having been uninterruptedly in the possession of a succession of receivers appointed by federal courts for a length of time before the appointment of a receiver of the same property by a state court, the federal court refused to order the property transferred to the receiver appointed by the state court on his application for such an order, it appearing that the receiver last appointed by the federal court had actual physical possession under a bill filed by the trustee of bondholders representing the bulk of the indebtedness of the road, while the receivers of the state court represented only junior creditors, and but little of the indebtedness.[2] In the United States Circuit Court for the southern district of Georgia, the Central Railroad Company of that state, in a suit instituted by a stockholder and in which trust companies, as trustees of bondholders afterwards became parties, was placed in the hands of a receiver. This receiver was appointed under a bill alleging that the company which he had in charge operated and controlled several lines of railway, among

[1] Fidelity Trust & Safety Vault Co. *v.* Mobile St. Ry. Co., (1892) 53 Fed. Rep. 687.

[2] Central Trust Co. of New York *v.* Chattanooga, Rome & Columbus R. Co., (1894) 62 Fed. Rep. 950. It was said by the court: "The facts here make no such case as was made in the litigation over the Atlanta and Charlotte Air-Line railroad, in which conflicting opinions as to the duty of the courts as to possession of receivers were expressed by Justice BRADLEY and Circuit Judge WOODS, in the case of Wilmer *v.* Railroad Co., 2 Woods, 409; Fed. Cas. No. 17,775, or in the Atlanta & Florida Railroad case, in which a decision was made by the judge of the state court (not reported), and afterwards heard by Judge SPEER of the southern district, in the case of East Tennessee, V. & G. R. Co. *v.* Atlantic & F. R. Co., 49 Fed. Rep. 608. In both of these cases there was something of a race for the possession of the property, and the rule may be derived from these cases as well as from all the other authorities on the subject that the court which has the actual physical possession of the property will determine the justice and rights of its possession, and any other court appointing a receiver, even prior to the appointment by the court having possession, will direct that an application be made to the court in possession as to whether its receiver is rightfully entitled to possession. Under the facts stated as existing in the case at bar, a very different question is presented; the state court appointed its receiver, as has been stated, with the knowledge of the fact that the property was in the hands of the federal court, and notwithstanding that fact, and it did not direct its receiver to

others the Port Royal and Augusta Railroad Company; that the railroad company was unable to pay the interest on its bonds, and that a receiver was necessary in order to prevent dismemberment and disastrous litigation, and was placed in charge of these various properties. Afterwards one who was appointed receiver in the state court for the Port Royal and Augusta Railroad Company filed a petition in the federal court showing his appointment as receiver, etc., and praying that the receiver of the Central railroad and its subsidiary properties be directed to surrender the property of the Port Royal and Augusta Railroad Company to petitioner. The federal court granted the prayer of the petition and directed the surrender of the property to the receiver of the state court, holding that the Central Railroad Company being merely a creditor of the Port Royal and Augusta Railroad Company and a majority stockholder therein, but having no rights of ownership in the property of the road, had no right to its possession and control, and the receiver of the creditor company had no greater rights than the company itself.[1] An order appointing a receiver of a railroad company, among other things providing that "all the books, vouchers and papers touching the operation of the road" should be delivered by its officers, servants and agents to such receiver, has been held to include all the books relating to the previous history of the corporation and all records of its transactions, and not confined to books relating to the future operation of the road, or to such as the receiver might specifically demand, and an order of court appointing a receiver of a railroad company, providing for the delivery to the receiver of "all and every part of the properties, interest, effects, moneys, receipts, earnings, etc., embraces the company's seal.[2] LaCombe, Circuit Judge, in the United States Circuit Court for the southern district of New York, denied the motion of a stockholder for leave to inspect the books of a corporation which was in the hands of a receiver, it appearing that the applicant did not become a stockholder until six months after the receiver was appointed; at the same time it was declared by the court that in case a stockholder of a corporation in the hands of a receiver sought leave to

take possession, but, on the contrary, the effect of the order was to direct the receiver not to take possession."

[1] Central R. R. & Bkg. Co. of Georgia *v.* Farmers' Loan & Trust Co. 52 Fed. Rep. 937.

[2] American Construction Co. *v.* Jacksonville, T. & K. W. Ry. Co., (1892) of New York, (1893) 56 Fed. Rep. 357.

inspect its books, it would be no ground for denying him the right that his object was to obtain material to convince the other stockholders that a plan of reorganization which had met the approval of a majority of the stockholders should not be carried out. And while it would be proper for the receiver to refuse to allow such an inspection of the books of the corporation until it was ordered by the court, it was no part of his duty to promote one plan of reorganization as against another, either by opposing the petition to be allowed such inspection or otherwise, but he should remain absolutely neutral.[1] In a motion for an attachment for contempt in an action against a railroad company for the appointment of a receiver, and in which a receiver had been appointed by order of the court, it was held that a collection by the vice-president of the company, of money due the company under a mail contract, after the appointment of the receiver, and depositing this money in bank to the company's credit, and attempting to dictate what disposition the receiver should made of it, constituted contempt.[2] The mortgage containing a provision that the mortgagor shall remain in possession until default, a receiver appointed in an action for its forclosure will have no right to earnings of the railroad corporation prior to the filing of the bill for foreclosure, though not paid until after his appointment.[3]

§ 547. The relation of the receiver to property leased by the corporation coming into his hands.— In this case an oil company manufacturing oil contracted with a railway company to purchase a certain amount of rolling stock, and lease it to the railway company at an agreed rental, the railway company agreeing to purchase the rolling stock on or before an appointed day, and pay for it in cash, or if it should be unable to do so to turn it over to the oil company at the expiration of the contract, in good order and condition. There was a further agreement that the charges for freights carried by the railway company in transportation for the oil company, might be applied to the payment of the rental and of the purchase money. The railway company was insolvent, and, before the expiration of this contract for rolling

[1] Chable *v.* Nicaragua Canal Construction Co., (1894) 59 Fed. Rep. 346.

[2] American Construction Co. *v.* Jacksonville, T. & K. W. Ry. Co., (1892) 52 Fed. Rep. 937.

[3] Hook *v.* Bosworth, 64 Fed. Rep. 443; s. c., 12 C. C. A. 208.

stock, in proceedings instituted by mortgage bondholders for foreclosure of their mortgage, was placed in the hands of a receiver, who continued to use the rolling stock. There was an intervention in the foreclosure suit by the oil company seeking to recover the balance of the purchase money from the receiver, and to secure the carrying out of the contract by him, and the retention of the amount of charges for freights due from the oil company, and their application to the payment of the rent and purchase money. The receiver answered the petition of the intervener, declining to complete the contract, and averred that the rental had been paid in full, and that there was a balance due him for freight. He also filed a cross-petition to recover the surplus. There was a provision in the contract between the lessor and lessee that if the latter, the railway company, became unable to pay its current debts in the ordinary course of business, it should be released from its obligation on returning the property. The United States Supreme Court held that the receiver had the right to return the property upon complying with the terms of the contract in respect to its return.[1] No part of the expenses of a

[1] Sunflower Oil Co. *v.* Wilson, (1892) 142 U. S. 313. Mr. Justice BROWN, speaking for the court, said: "The case is not unlike that of Express Company *v.* Railroad Co., 99 U. S. 191. In that case, the express company agreed to loan the railroad company twenty thousand dollars upon its notes, to be expended in repairs and equipments. In consideration of this, the railroad company agreed to provide the necessary privileges and facilities for the transaction of all the business of the express company over its road; and to charge a certain sum for transportation, which was to be credited monthly toward the payment of the loan, with a proviso that if the loan was not paid within a year the contract should continue in force for a further period, or until the whole had been repaid. A mortgage upon the road having been foreclosed, the receiver repudiated the contract, forbade the express company from further using the cars of the railroad company unless upon conditions whereby the contract was virtually surrendered or ignored, and the express company was compelled to abandon the road, although the money loaned, with a portion of the interest thereon was still due and unpaid. It filed a bill for specific performance, alleging that the railroad company having conveyed away its property, and being in fact insolvent, the violation of the contract could not be compensated by any damages that might be recovered at law. This court dismissed the bill, holding that as the plaintiff had no lien and the contract was simply for the transportation of persons and property, the court could not require either a specific performance by the receiver, or the satisfaction of the plaintiff's demand of money; and that the express company had, therefore, no standing in a court of equity. The case of Coe *v.* New Jersey Midland Railway, 27 N. J. Eq. 37, is also instructive in this connection. In that case, the Rhode Island Locomotive Works Company entered into an agreement with the railway company to furnish the latter certain locomotives and tenders, as upon lease, but with the agreement that, upon payment in full of the rent required, they should become the property of the railway. The rent was payable in installments, for which the company gave its notes; at the time of the appointment of the receiver there was due for rent about one hundred and twenty thousand dollars, and the locomotives were then in possession of the receiver and in use upon the road. Petitioners based their claim to relief upon the ground that the receiver requested them to leave the locomotives in his possession for use on the road, he guaranteeing to keep them in good order, and promising to apply for authority to pay the claim. In defense, the receiver alleged a notice by bondholders not to pay the rent or deliver the certificates therefor, which had been issued upon his application, because the property was not worth the amount agreed to be paid, and it was not for the interest of the trust that the rent should be paid. It was held that petitioners had no equity arising from the conduct of the receiver to have the contract specifically performed, without regard to the advantage or disadvantage of the trust fund; that, although they appeared to be willing, up to the time they were warned not to do so, to pay for the property according to their agreement, it might have been an improvident act on their part; that the fact that the receiver had applied for leave to issue the certificates to pay the rent did not bind them; and that the court would not grant the prayer of the petitioners until satisfied that it was for the interest of the trust that it should be done; but, that the petitioners would be allowed just compensation for the use of the property while held by the receiver."

receivership, where a receiver has been appointed for the benefit of a railroad company and its creditors, can be properly charged to a company whose roadway was leased to the former.[1] The United States Circuit Court for the eastern district of Wisconsin has declared these rules: The appointment of receivers for a railroad system, and their taking possession of a leased line, does not of itself work an assignment or adoption of the lease, so as to make the receivers liable for the stipulated rentals. Receivers have, as a general rule, a reasonable time to determine whether they will adopt a lease, or will merely pay to the lessor the net earnings of its road, subject always to the lessor's right to enter for condition broken. But where the lessor immediately demands of the receiver and of the court either an adoption of the lease or a surrender of the road, and against its protest a decision was delayed for several months, in order to determine which policy was expedient, they held that the receivers should

[1] Brown *v.* Toledo, P. & W. R. Co., 35 Fed. Rep. 444.

equitably pay the full rental during the time of their possession.[1] This Ohio railroad company, the road of which constituted one of the leased lines of the Erie railway system, raised this same question as to the liability of the receivers of the Erie Company on account of the lease contract on its part of the Ohio road before the United States Circuit Court for the northern district

[1] Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (Wisconsin Central R. R. Co., Interveners), (1893) 58 Fed. Rep. 257. JENKINS, Circuit Judge, first quoted from Oil Co. *v.* Wilson, 142 U. S. 313, 322; s. c., 12 Sup. Ct. Rep. 235, and then said: "In other words, when the court, upon the petition, and not the prayer of the complainant, appoints receivers, who are directed to take possession of the leased lines of railway operated in connection with the main line, such receivers take by order of the court, and do not, therefore, by the mere act of such possession, become assignees of the leases, they having, so to speak, a breathing space to determine whether or no they will assume the covenants of the lease. This is because of the necessities of the case. There is no other person to take immediate possession from an insolvent corporation in the interest of the public; and, as because of the public nature of the enterprise, the road must be kept a going concern; the performance of the duties of common carrier must not be permitted to be interrupted; the mails of the government must be transported; therefore, temporary possession is allowed to be taken; and, as a general rule, compensation for such possession must be measured by the terms of the instrument under which such possession was originally acquired and held. But that possession does not ordinarily operate to render the receivers assignees of the leases. Undoubtedly there are exceptions to the rule, arising because of the peculiar circumstances of the case, which equitably require the application of a different measure of compensation." The court regarded Railroad Co. *v.* Humphreys, 145 U. S. 82; s. c., 12 Sup. Ct. Rep. 787, such an exception, and distinguished it. He said: "There is, I think, a manifest distinction between that case and the one at bar. There the lessor, the inactive lessor, sought to obtain preference over a mortgagee not applying for the receiver; a lessor who sought to obtain rental pursuant to the terms of the lease when he was a party to the suit, and could have asked and would have received possession, but allowed the road for a long time to be operated by the receivers knowingly at a loss. Here possession of these leased lines was asked for by the trustees of the mortgage. The court was asked by the trustee to take possession of this leased line and operate it in connection with the main line of the defendant company as a unit, and to keep and maintain in its integrity and operate the entire system of roads from Chicago to the Pacific. In other words, as plainly as language could state it, the trustee * * * asked the court to adopt this course, and to enter into possession and operate it in the interest of the bondholders. In the Quincy case the bill was filed by the insolvent company. It was unable longer to continue the operation of the road, and petitioned the court, in the interest of every one interested, as well as its own interest, to take possession of the leased lines, and the lessors were parties to that suit. And the lessors, under the circumstances, without application to the court for possession, allowed the road to be operated from May 29, 1884, to July 15, 1885, by the receivers at a loss to its knowledge, and without the slightest attempt to obtain possession. It could well have been held in that case that such action or non-action of the lessor would be held in equity to be an assent to the operation of that line by the receivers. But here possession was not only taken at the request of the trustee of the mortgage, upon the assertion that the severance of the trunk line to Chicago would result in ruinous sacrifice, but it has been continued against the continued protest of the lessors, who, almost from the date of the filing of the bill, have sought to compel the receivers to determine whether or no they will retain possession, adopting the lease, and if not, that possession should be surrendered to the lessors; and, also, when delay became inevitable, by the demand and act of re-entry they put themselves in the legal position where they could lawfully require the surrender of the premises, unless the court should, upon principles of equity, remove the forfeiture and allow the possession to continue in the receivers, adopting the lease and paying all past-due rentals. So that here the lessors have been continuously knocking at the door of the court demanding possession of the demised premises, and possession has been withheld from them against their consent and against their protest."

of Ohio. This latter court held that the receivers of a railroad company have no power to abrogate a valid lease of railroad property made to the company by another company, and, as between lessor and lessee, the lease must stand until abrogated under some of the conditions contained in the lease. Further, the mere appointment of receivers for a railroad company embracing a system of leased lines, and their taking possession of a leased road, did not, even if the bill showed that the receivership was brought about for the purpose of preventing a disintegration of the system, render the receivers assignees of the lease, or require the adoption of the lease by them, so as to make the rental a preferred claim which they were bound to discharge; neither did the fact that they continued to operate the leased line for some time work an adoption of the lease, when the lessor had never demanded a surrender of its road, although entitled to do so because of breach of condition by non-payment of rent. And rental accruing under a railroad lease prior to the appointment of receivers for the lessee was held to be an unsecured liability entitled to no priority to the mortgage bondholders.[1] A railroad company, in the hands of receivers, had been operating another company's road for several years under a lease by the terms of which it was to pay as rental thirty-two per cent of the gross

[1] New York, P. & O. R. Co. *v.* New York, L. E. & W. R. Co., (1893) 58 Fed. Rep. 268; agreeing with LACOMBE, C. J. Park *v.* New York, L. E. & W. R. Co., (1893) 57 Fed. Rep. 799.

earnings. It was also provided that a breach by the lessee company of any of its covenants should be cause of forfeiture, at the option of the lessor company, and that thereupon the latter might enter into possession of the property. When the receivers were appointed on the bill declaring the lessee company insolvent, the lessee was indebted for rental more than $300,000. The receivers had paid for the use of the property out of the assets more than that amount — a sum a little more than the net earnings of the leased property for the same period. The lessor company, in a petition to the court showing the importance to it of collecting promptly its rental in order to enable it to pay its obligations to its bondholders and to subordinate roads leased by it, asked that the court instruct the receivers to perform all the obligations of the lease, and to pay the rent then due; that, if without money to make the payment, the receivers be ordered to issue receivers' certificates for all rent due or to become due, these certificates to be deemed a charge and lien upon the property of the lessee company in the possession of the court through its receivers, prior to the outstanding mortgages of the lessee company. The petition did not ask a forfeiture of the lease for covenants broken. The United States Circuit Court for the southern district of New York, considering the petition, held that the receivers did not, by taking possession under the order of the court, become assignees of the terms of the lease, committed to the obligation, in any event, to pay the full sum stipulated as rental by the lease; neither had they retained possession for such an unreasonable time, or under such circumstances, as amounted to an election on their part to accept the lease; and it appearing that more than the net earnings of the leased property for the period during which the receivers had been in possession of it had been paid to the lessor, the court declined to instruct the receivers to pay any more out of the general *corpus* of the property in their hands.[1]

[1] Park *v.* New York, L. E. & W. R. Co., (1893) 57 Fed. Rep. 799; citing on the first point Quincy, etc., R. Co. *v.* Humphreys, 145 U. S. 82; s. c., 12 Sup. Ct. Rep. 787; St. Joseph, etc., R. Co. *v.* Humphreys, 145 U. S. 105; s. c., 12 Sup. Ct. Rep. 795; on the second point, Miltenberger *v.* Railway Co., 106 U. S. 286; 1 Sup. Ct. Rep. 140; Kneeland *v.* Trust Co., 136 U. S. 101; s. c., 10 Sup. Ct. Rep. 950; Central Trust Co. *v.* Wabash, etc., R. Co., 23 Fed. Rep. 863; 34 Fed. Rep. 259. When receivers will be held liable for the rent of a leased line and interest during the term of their receivership. Brown *v.* Toledo, P. & W. R. Co., 35 Fed. Rep. 444.

A receiver does not simply by virtue of his appointment become liable upon the covenants and agreements of a railway company of which he may be receiver.[1] Upon taking possession of property, for instance, leased to the company he is entitled to a reasonable time to elect whether he will adopt the contract under which it was leased, or whether he will insist upon the inability of the company to pay, and return the property in good order and condition, if the contract calls for that, paying, of course, the stipulated rental for it so long as he may have used it.[2] The court has power, in a foreclosure trial, on consulting the receivers, and without notice to the mortgagees, to order the lease of another road which is found necessary to the profitable management of the mortgaged property.[3] A receiver of a railroad embracing a leased road, cannot recover of the lessor road expenses incurred in running it, but is entitled to payment for betterments of its roadbed.[4]

§ 548. Powers of receivers as to contracts, etc. — The United States Circuit Court for the district of New Jersey, in which a creditor of a corporation of that state which had already been placed in the hands of a receiver by a court of the state brought his action against the receiver and others to set aside alleged fraudulent conveyances made by the corporation, held that he could not maintain the suit; for, as the New Jersey statute relating to corporations vested the receiver with all the rights and equities of the creditors, the receiver alone could enforce them. Further, the mere refusal of the receivers to act did not authorize the creditor to sue in person, as the statute of New Jersey gives to any person aggrieved by the receiver an appeal to the chancellor who appointed him. Besides, a creditor of a business corporation which had been placed in the hands of a receiver could not, without leave of the court appointing him, maintain a suit in another court to set aside fraudulent conveyances of the corporate assets. Furthermore, a creditor having a claim of less than $2,000 against an insolvent corporation, suing for himself alone, could not maintain the suit in a Federal Circuit Court on

[1] Hoyt *v.* Stoddard, 2 Allen, 442.

[2] Turner *v.* Richardson, 7 East, 335; Commonwealth *v.* Franklin Insurance Co., 115 Mass. 278; Sparhawk *v.* Yerkes, 142 U. S. 1.

[3] Mercantile Trust Co. *v.* Missouri, K. & T. Ry. Co., (1889) 41 Fed. Rep. 8.

[4] Phinizy *v.* Augusta & Knoxville R. R. Co., 56 Fed. Rep. 273.

the ground of diverse citizenship, notwithstanding the fact that he sought to set aside fraudulent conveyances of corporate assets greatly exceeding $2,000 in value.[1] The receiver of the property of a railroad company may terminate at will an arrangement which he has made for the transportation of the freight and passengers of another railroad company over the line of road under his control, where there is no provision making the arrangement obligatory on either party for any stated period of time, without previous notice to the other company.[2] The receiver of a railroad in Florida, where discrimination in freight rates is a criminal offense, has no right to make such discrimination.[3] On a petition

[1] Werner *v.* Murphy, (1894) 60 Fed. Rep. 769. In the opinion GREEN, D. J., gives full consideration to the law of New Jersey governing receivers under the jurisdiction of its laws and courts.

[2] Investment Co. of Philadelphia *v.* Ohio & N. W. Ry. Co., (1889) 41 Fed. Rep. 378.

[3] Cutting *v.* Florida Ry. & Nav. Co. (Mallory et al., Interveners), (1890) 43 Fed. Rep. 747, following Missouri Pac. Ry. Co. *v.* Texas & Pac. Ry. Co., 31 Fed. Rep. 862. What kind of contract with reference to transportation of freight over railroad in his possession a receiver cannot make, see International & G. N. R. Co. *v.* Wentworth, (Tex. Civ. App. 1894) 27 S. W. Rep. 680. In Seibert *v.* Minneapolis & St. L. Ry. Co., (Minn. 1894) where two railroad companies agreed that each should construct or cause to be constructed a specified part of a continuous line of railroad between two terminal points and make certain connections, and that each should have the concurrent use of the whole line and have certain other traffic arrangements with the other, and that this contract should be in force for a certain number of years, the line was so constructed, and, after being so used for some time, a receiver of one of said companies was appointed in a foreclosure suit brought against it. The other company presented a claim for rent, switching charges, expense of handling freight and other operating expenses accruing to it under the contract before the receiver was appointed, and the court below ordered the payment of the same by the receiver with interest. The Supreme Court of Minnesota held that it was proper to order the payment to be made, it being fairly to be inferred from the order of the court and other proceedings that the court deemed this contract a valuable asset, and deemed it for the best interest of the estate that the receiver should adopt the contract, and that it was necessary to pay the claim in order to keep the contract in force. In Central Trust Co. *v.* Marietta & North Ga. Ry. Co. (Blue Ridge Marble Co., Intervener), (1892) 51 Fed. Rep. 15, it appeared that the railroad company contracted with the intervener to carry marble from one point to another and allow the same to be stopped over at an intermediate point to be dressed and then reshipped and carried to a terminus of the road without extra charge, the entire charge for freight being paid in advance. The United States Circuit Court held that the receiver appointed in this suit of the bondholders to foreclose their mortgage on the railroad could not be compelled to transport the marble on the terms of this contract, although the freight had been paid for such transportation before the appointment of the receiver. Following Express Co. *v.* Railroad Co., 99 U. S. 191.

by contractors against the receivers of a railroad to secure payment for the erection of a building, the court referred the cause to a master to ascertain the amount "justly and equitably due as the true value of the work done and material furnished." The master found the work was done under a contract between the receivers and the builders, refused to hear evidence as to value, and reported the contract price as the amount due. The court, after a hearing on exceptions, confirmed the report and entered judgment thereon. It was held by the United States Circuit Court of Appeals for the eighth circuit that while the order of reference was open to the construction that the actual value of the work and material was to be ascertained, yet, as the trial court had held that it was not intended to bear so broad a construction, and had confirmed the report, an appellate court would not be justified in holding the contrary where no injustice had resulted. These facts appeared in the case: That while these railroad buildings were in course of construction a foreclosure suit was instituted against the company, and two receivers appointed. Shortly after their appointment, by a joint letter, the receivers notified the contractors to stop work, stating that they would later furnish designs and directions for completing the work, and in the letter said: "And you will name a gross sum for the performance of the same, which will be submitted to the court for approval." New plans and specifications were then prepared and approved by the court, and an order was entered directing that the buildings be completed in accordance therewith. The receiver in active charge of that portion of the road notified the contractors of this order, and soon afterwards they answered by letter submitting a bid for which they would complete the work on the new plans. The active receiver testified that the receivers accepted the bid, and that a formal contract was prepared and was signed by the contractors, but was never signed by the receivers. Relying on this contract the contractors completed the work. The other receiver testified that he knew nothing of the bid, but that he afterwards saw the work going on, and assumed it was with his colleague's concurrence, and without any estimates or contract. The Court of Appeals held that these facts were sufficient to justify the mas-

ter in finding that the work was completed under a binding contract with the receivers.[1] Where a bill was filed by the president and directors of a railroad company, alleging that as a result of an unlawful lease and the diversion of its income it had been embarrassed; that if properly managed it might extricate itself from its difficulties, and the court appoints its president receiver for the purpose of preserving the property, and, with the aid of the court, placing it upon a prosperous footing, and no lien creditors are parties, it is competent for such president receiver, with the authority of the court, to pledge collateral and equitable assets of the company to secure loans necessary to its operation, and also to incur a liability for the expenses of a refunding scheme. If, however, before such expenses are paid, creditors holding liens upon the property are made parties, the court will not *ex parte* allow the expenses of such refunding scheme to be paid by the receiver.[2] A receiver of a railroad, appointed with authority "to make all contracts that may be necessary in carrying on the business of said railroad, subject to the supervision [of the] court [appointing him]," has no authority to make a lease for a term of general offices, without authority from that court, and to bind his successors and the property therefor for the term, without direction from or sanction by the court. Further, the Supreme Court of the United States held that the facts that the receiver's accounts showed, monthly, the payment of the rent of such a lease, and that that rent was reasonable, and that the accounts as rendered were passed by the master and reported to and approved by the court, did not amount to a sanction of the lease for the term.[3] This insolvent railroad company, as assignee of another

[1] Girard Life Insurance, Annuity & Trust Co. *v.* Cooper, (1892) 51 Fed. Rep. 332. When proper to extend the receiver's powers, see Mercantile Trust Co. *v.* Missouri, Kansas & Texas Ry. Co., 41 Fed. Rep. 8. When an application of the trustees of an underlying mortgage to have the property of the company turned over to a receiver appointed in their suit to foreclose by a receiver of the whole system of roads should be denied, see Central Trust Co. *v.* Wabash, St. Louis, etc., Ry. Co., 25 Fed. Rep. 693.

[2] Central R. R. & Bkg. Co. *v.* Farmers' Loan & Trust Co. of New York, (1893) 54 Fed. Rep. 556.

[3] Chicago Deposit Vault Co. *v.* McNulta, (1894) 153 U. S. 554. Mr. Justice JACKSON, in the opinion of the court, said: "In Cowdrey *v.* Galveston, Houston, etc., Railroad, 93 U. S. 352, it was held that a receiver is not authorized, without the previous direction of the court, to incur any expenses on account of property in his hands beyond what is absolutely essential to its preservation and use, as contemplated by his appointment. Accordingly, the expenditures of a receiver to defeat a proposed subsidy from a city, to aid in the construction of a railroad parallel with the one in his hands, were properly disallowed in the settlement of his final account, although such road, if constructed, might have diminished the future earnings of the road in his charge. The same general principle is recognized in Union Trust Co. *v.* Illinois Midland Ry. Co., 117 U. S. 434, 479, where debts for considerable sums of money, borrowed by the receiver without previous authority from the court, were not allowed any priority out of the trust fund, although the moneys borrowed were applied to pay expenses of the receivership, such as supplies, repairs and pay rolls, and to replace moneys which had been so applied, for the reason that no order of the court had been obtained to borrow funds for those purposes. In Lehigh Coal & Navigation Co. *v.* Central Railroad, 35 N. J. Eq. 426, it was said that 'the receiver may undoubtedly appropriate moneys in his hands belonging to the trust to such purposes connected with the trust as he may think proper, always taking the risk that the court will finally approve his action; but he has no authority to bind the trust by contract without the authority of the court. Until his contracts are approved and ratified by the court the court is at liberty to deal with them as it shall appear just, and may either modify them or disregard them entirely. * * * All persons dealing with receivers do so at their peril, and are bound to take notice of their incapacity to conclude a binding contract without the sanction of the court.' This states the correct rule upon the subject, especially in respect to contracts involving large outlays, and which may extend beyond the life of the receivership. The same general rule is stated in Beach on Receivers, § 257, as follows: 'But a receiver is not allowed to exercise his discretion in applying the funds in his hands. These he holds strictly subject to the direction of the court, and only to be disposed of upon its order. Neither can he enter into contracts without the approval of the court. Although as receiver he may enter into negotiations and make such agreements as would be binding upon him as an individual, yet, in order to affect the fund in his hands, his acts must be ratified by the court. The rule is so well established that it has been decided that all persons contracting with a receiver are chargeable with knowledge of his inability to contract, and enter into contracts with him at their own peril, and that the court has unquestioned power to modify or even vacate his agreements.' To the like effect is a statement of the rule in section 186 of High on Receivers."

railroad company, held a half interest in a certain bridge and piece of track, the maintenance of which was provided for in a general contract with the other joint tenants. Receivers of the insolvent company, including its leased lines, among them the assignor railroad company's, were appointed and made a special contract for specific repairs, which were made by the joint tenant in accordance with this contract. Thereafter a special receiver was appointed for the assignor company. Upon the intervention of the joint tenant the federal court held that the receivers of

the insolvent company were liable as such for the repairs, though as against the assignor company they might have had a good claim therefor.[1]

§ 549. Powers of the court and its receivers as to regulating wages of employees.— Where the property of a railway or other corporation is being administered by a receiver under the superintending power of a court of equity, it is competent for the court to adjust difficulties between the receiver and his employees, which, in the absence of such adjustment, would tend to injure the property and to defeat the purpose of the receivership. It follows, then, that it is in the power of the court, in the interest of public order and for the protection of the property under its control, to direct a suitable arrangement with its employees or officers, to provide compensation and conditions of their employment, and to avoid, if possible, an interruption of their labor and duty, which will be disastrous to the trust and injurious to the public.[2] The power of a court appointing a receiver of a railroad corporation over such receiver's action, being under consideration, the United States Circuit Court for the northern district of Ohio declared these rules: The court appointing a receiver to carry on the business of the corporation necessarily commits to the discretion of the receiver the management of all administrative details relating to the business, and will not interfere with his management unless an abuse of his discretion is made to appear. In this particular case, upon the complaint by the receiver's employees in respect to a reduction of their wages, it was held that the court would not interfere to reverse the receiver's administration by settling the details of the complaints involving, as this would, an extensive investigation of administrative details, but, in case an abuse of discretion on the part of the receiver was made manifest, the court would select a new receiver, to whom such matters might more satisfactorily be intrusted.[3] The United States Circuit Court for the district of

[1] Central Trust Co. of New York *v.* Wabash, St. L. & P. Ry. Co. (St. Louis, K. & N. W. Ry. Co., Intervener), (1892) 52 Fed. Rep. 908.

[2] Waterhouse *v.* Comer, (1893) 55 Fed. Rep. 149, in which the court directed the receiver of the railroad to enter into an appropriate contract with the locomotive engineers in his employ, subject to the general opinion of the decision of the court with reference to rule 12 of the brotherhood.

[3] Consolidated Trust Co. of New York *v.* Toledo, St. L. & K. C. R. Co., (1894) 59 Fed. Rep. 514.

Washington declined to make an order that the receiver appointed by the court of a railroad company should conform to the terms of a certain contract made by the company with its employees prior to his appointment as receiver, whereby the employees were not to be discharged, except for cause, to be determined by arbitrators, holding that the receiver was not bound by such agreement.[1] The court here refused to confirm the action of the receivers of an insolvent railroad system in reducing the wages and changing the regulations for the conduct of its employees which were in force when the property came into the possession of the receivers, the employees affected not having been notified of the proposed changes, and given an opportunity to point out before the receivers any inequalities or injustice that would be caused by these changes.[2] It appeared here that, as the results of conferences beween the managers of this railroad company, certain rules, regulations and schedules, which had remained substantially unchanged for several years, determined mainly the relations between the company and its employees, as well as their rates of wages. That no change should be made in them or in the rate of wages without certain notice to the organization, the members of which would be affected, was one of those rules and regulations. The receivers appointed for this insolvent railroad company had a set of rules and regulations and schedules of wages prepared by themselves approved by order of the United States Circuit Court for the district of Nebraska, and authority was given them to put the same in force. The Circuit Courts of other districts through which the road extended having declined to give effect to the order in those districts,[3] the receivers applied to the Circuit Court for a rehearing before the Circuit judges. Upon this rehearing, the court held that the schedules of wages established for so long a time between the company and its employees must be presumed to be just and reasonable, and that the new and reduced schedules adopted by the receivers without notice to the employees or their representatives would not be approved by the court, although recommended by a majority of the receivers.[4] In another case

[1] In re Seattle, L. S. & E. Ry. Co.; Grievance Committee of Brotherhood of Railway Trainmen, Lodge No. 196, *v.* Brown, (1894) 61 Fed. Rep. 541.

[2] Ames *v.* Union Pac. Ry. Co., (1894) 60 Fed. Rep. 674.

[3] See Ames *v.* Union Pac. Ry. Co., 60 Fed. Rep. 674.

[4] Ames *v.* Union Pac. Ry. Co., (1894) 62 Fed. Rep. 7.

before the federal courts, it appeared that a railroad company, the property of which was the equipment and leasehold of another road, passed into the hands of a receiver. The annual rent was a first lien on the equipment, and the leasehold was subject to forfeiture for non-payment of the rent. The earnings of the road fell off, owing to general depression, until they were not sufficient to pay the rent. The receiver thereupon ordered a reduction of ten per cent in wages of all employees. Such a reduction, it also appeared, had been before then made by competing roads, and that the working time of each one of the employees had been lessened by the receiver in order to avoid a discharge of any of them. The Circuit Court held that this reduction was not unreasonable in such a case.[1] In the United States Circuit Court for the northern district of Georgia, the rule declared as to the proper treatment of employees of a railroad company operated by a receiver, in case of injury to those employees, is as follows: A person in the employ of a receiver having been injured while in the discharge of his duty, without negligence on the part of either, the court may properly order that his wages be paid to him for the time during which he continued disabled, the view of the court being that the officers of the court should be required to act towards their employees as persons of ordinary humanity and right feeling would act under similar circumstances. The usual rule was, however, limited in this wise: The compensation should be confined to faithful and deserving employees and to those who merit such consideration.[2]

§ 550. Receiver's certificates — when they will be authorized — the lien of such certificates and its enforcement. — Here the receiver had been appointed on the petition of a comparatively small holder of stock in a small local narrow-gauge railroad company. The court which had appointed him refused to authorize him to issue receiver's certificates to provide for new equipment, additional sidings and permanent structures, in order to test its earning capacity if fully developed, as the issuing of such certificates was opposed by all other interests, and the

[1] Thomas *v.* Cincinnati, N. O. & T. P. Ry. Co., (1894) 62 Fed. Rep. 17.

[2] Thomas *v.* East Tennessee, V. & S. Ry. Co. (Cook, Intervener), (1894) 60 Fed. Rep. 7, limiting rule in Missouri Pac. Ry. Co. *v.* Texas & P. Ry. Co., 33 Fed. Rep. 701; 41 Fed. Rep. 319.

first mortgage bondholders were pressing for a foreclosure of their past due mortgage; it was furthermore apparent that the road could not in any reasonable time cancel the certificates, and resume payment of interest on its bonds, and that the first measure of the new owners would be to change the road to a standard gauge, thus rendering the proposed improvements useless.[1] It was held in this case, where a receiver of a railroad had been appointed on the petition, not of the bondholders, but of a stockholder, and no earnings had been diverted to pay interest on bonds, there was no lien or equity requiring the payment of past-due labor and material claims out of the *corpus* of the property by the issuance of receiver's certificates. But there was, however, an equity requiring payment of those whose labor actually kept the road a going concern out of any net earnings which the receiver might realize, but such earnings could not be anticipated by raising money on receiver's certificates except by agreement of the parties.[2] Should all parties consent that the receiver of a railroad company, though not engaged in operating the road, be, and he is authorized by order of court to issue certificates which shall constitute a lien on the company's property superior to certain prior mortgages, and the money obtained on such certificates is used in preserving and improving the property, the purchasers of the property at a subsequent sale to foreclose said mortgages are estopped from denying the validity of the certificates.[3] The order for certificates of the receiver in this case, on his *ex parte* application had been modified so as to declare some of the certificates invalid, with the privilege to the holders of such certificates to intervene in the suit and have their validity adjudicated. It was held that a petition in intervention by such certificate holders, which recited the modified order, did not thereby admit the invalidity of the certificates; nor did the fact that the principal of such certificates was not due make the intervention premature, if the interest thereon was then due and unpaid.[4] And the receiver who issued the certificates and who has in his hands the funds from which they should be paid, is a necessary party defendant to such intervention.[5] In a foreclosure

[1] Street *v.* Maryland Central Ry. Co., (1893) 59 Fed. Rep. 25.

[2] Ibid.

[3] Central Trust Co. *v.* Sheffield & Birmingham Coal, Iron & Ry. Co. (Anniston Loan & Trust Co., Intervener), (1890) 44 Fed. Rep. 526.

[4] Ibid.

[5] Ibid.

suit of a mortgage executed by a railroad company which received the railroad property by conveyance from a purchasing committee of bondholders of a former railroad company carrying out a plan of reorganization in their interest, the holder of receiver's certificates which, by order of the court in which the mortgage against the former railroad company was foreclosed, had been issued and sold to this holder, intervened by petition to enforce the prior lien of these certificates. The court declared these rules to be applicable in this case, to wit: The lien of receiver's certificates continues as long as the order authorizing their issuance remains in force, though such order was made without notice to parties interested; and the fact that a reference is had to determine all claims against the receiver, and a report is confirmed which makes no allusion to the certificates, is not an adjudication against them, when it appears that they were not presented or considered, and that their holder had no notice of the reference.[1] Receiver's certificates, which are ordered to be paid out of the income of the road from time to time, are in the nature of call loans, and the holders have a right to presume that the receiver will notify them when the loan is to be called or the money paid. Where purchasers of receiver's certificates have paid their par value to the receiver, without notice of any facts to put them upon inquiry, their lien is not affected by the fact that the receiver appropriated the money to his own use.[2] It appeared in this intervention in a foreclosure suit, which was to enforce the payment of receiver's certificates against the purchaser of the corporation's property at foreclosure sale, that the president of the bank in which the receiver kept his deposits, having been authorized by the receiver to sell certain receiver's certificates, made the sale after his authority had been revoked, and caused the amount realized from the sale of certificates to be credited to the receiver on the books of the bank, and on the receiver's pass book. The receiver did not repudiate the sale, but, on the contrary, drew checks against the deposits, and reported the transactions to the court, which in the foreclosure

[1] As to the validity of the first lien of such certificates upon the railroad, see Wallace *v.* Loomis, 97 U. S. 146, 162; Union Trust Co. *v.* Illinois Midland Ry. Co., 117 U. S. 434; s. c., 6 Sup. Ct. Rep. 809; Vilas *v.* Page, 106 N. Y. 439. 451, 452; s. c., 13 N. E. Rep. 743.

[2] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co., (1892) 50 Fed. Rep. 874.

decree recognized the validity of the certificates, and directed that the sale should be made subject thereto. The United States Circuit Court of Appeals for the fifth circuit held that the receiver was estopped to question the validity of the certificates as against an innocent purchaser. They also held the fact that the receiver, on afterwards learning that the bank was insolvent, demanded and received from the bank and from the president, personally, certain collateral securities, to protect his deposits, not to be a repudiation of the sale of the certificates, but rather a fresh ratification and acceptance of the deposits as the proceeds of the sale. The deposits representing the proceeds of the sale of certificates having been placed in the bank, by its president, in the form of checks, drafts, etc., on other banks, which were in fact duly honored by these other banks, the deposits must be held to have come into the receiver's hands, within the rule which makes the receipt of the proceeds by the receiver a condition precedent to the validity of the certificates, notwithstanding the fact that the bank was never in a condition to pay over any considerable proportion of the deposits to the receiver. Furthermore, the court, under the circumstances of this case, having recognized the validity of the receiver's certificates, and caused the foreclosure sale to be made subject to the lien of the certificates, was bound to recognize the estoppel of the receiver, as the court's agent, and to protect the innocent purchaser of the certificates by enforcing the same against the purchaser of the property.[1] The Court of Civil Appeals of Texas, in an action by a trustee of a corporation mortgage securing bonds to foreclose the same on lands of the corporation situated in that state, upon an intervention through which the holders of certain receivers' certificates which had been issued under order of a court of New York, in which proceedings to wind up this insolvent corporation incorporated in that state were pending, sought to have the certificates declared a prior lien, held that a court of another state having no jurisdiction to appoint a receiver for property situated in Texas, it could not authorize its receiver to issue certificates which should be a lien upon the property situated in Texas. Further, the fact that

[1] Alabama Iron & Ry. Co. *v.* Anniston Loan & Trust Co., (1893) 57 Fed. Rep. 25. See for the same principle as declared in the text, Levy *v.* Bank, 4 Dall. 234; Koontz *v.* Bank, 16 Wall. 196; Oddie *v.* Bank, 45 N. Y. 735; Bank *v.* Burkhardt, 100 U. S. 686.

in such case the president of the insolvent corporation attempted, under an order of the foreign court, to convey the property to the receiver, was immaterial.[1] It seemed that certain of the bondholders of this corporation had entered into an agreement with the purchasers of these certificates of the receiver of the New York court, that the certificates held by them should be a prior lien upon the lands in Texas. The Court of Civil Appeals affirmed the judgment of the court below that the rights of these purchasers of certificates could not be adjudicated under the agreement with these bondholders in the foreclosure suit without making those bondholders parties to the action.[2] The main question made in this case was whether the lien of the receiver's certificates upon the property of the former railroad company, against which the proceedings in foreclosure were conducted, in which these certificates were issued, had been discharged. The

[1] Pool *v.* Farmers' Loan & Trust Co., (Tex. Civ. App. 1894) 27 S. W. Rep. 744.

[2] Pool *v.* Farmers' Loan & Trust Co., (Tex. Civ. App.) 27 S. W. Rep. 744. The court said: "It is unquestionably true that in a number of cases the trustee appointed by the instrument creating the trust will be held authorized to represent the beneficiaries therein in suits involving the title to the trust property, as well as in the execution of the powers expressly conferred upon him. This is especially true where the parties are numerous, as in mortgages given to secure railroad bonds, and would include the mortgage given to appellee by the copper company in this case. * * * It will be observed, however, that the instrument relied upon in this case is not signed by the owner of the property, and no power is attempted to be conferred upon appellee, as trustee in the original mortgage, to represent them in reference to this contract, even by the bondholders who did sign it. It seems to be an agreement between appellants and the signing bondholders pure and simple. We think it clear that the agreement conferred no power upon appellee to represent the signing bondholders in reference to any of the matters embraced therein, for the simple reason that it attempted to give no such authority. We are, therefore, of opinion that these bondholders were necessary parties to a decree giving appellants priority over them by reason of the stipulations contained in that instrument." Citing Hudson *v.* Elevator Co., 79 Tex. 401; s. c., 15 S. W. Rep. 385. The court, as to how these purchasers of receivers' certificates might secure their rights, said: "As the proceeds of the sale under the judgment rendered by the court below will be paid to appellee, as trustee in the original mortgage, we see no reason why appellants cannot, in a proper proceeding in the New York courts, in which state all the parties are domiciled, have that part of such proceeds which would be due the bondholders who signed the instrument above set forth first applied to the discharge of these receivers' certificates, in compliance with its terms."

suggestion was that, by virtue of the sale and transfer of the railroad property to the purchasing committees of the bondholders in that suit, the lien was transferred from the property to the fund, which was paid into court in the foreclosure suit. It appeared that the decree confirming the rule directed the conveyance to be made expressly subject to the payment of any sums in cash on account of the purchase price which the court might afterwards direct, and a vendor's lien to be reserved for security. These provisions were incorporated in the deed to the committee of bondholders, and in their deed to the new corporation organized by the bondholders, the mortgage of which new corporation was here being foreclosed. The court held that the reservation had the force of a covenant running with the land, and, as no cash was paid in, the lien of the certificates was not transferred to the fund arising from the order, but was continued on the property.[1] It has been held that where receiver's certificates have been issued by the direction of a federal court in one state, and ancillary proceedings were had in a federal court of another state into which the road extended, the latter court had jurisdiction to enforce the lien of the certificates even in a separate suit and against a company which purchased the road after the sale in the original proceeding.[2]

§ 551. Rules as to claims against receiver growing out of rolling stock coming into his possession.— In a case before the United States Circuit Court of Appeals for the fifth circuit it appeared that an improvement company, interested in the con-

[1] Mercantile Trust Co. *v.* Kanawha & Ohio Ry. Co., (1892) 50 Fed. Rep. 874. It was said: "The precise point was adjudicated in Vilas *v.* Page, 106 N. Y. 439; s. c., 13 N. E. Rep. 743. ANDREWS, J., at page 454, 106 N. Y. Rep., and page 747, 13 N. E. Rep., says: "If the purchasers on the sale, whether bondholders or third persons, had paid the purchase money in cash, or secured its payment, there would, we conceive, be no doubt that the lien would be transferred to the proceeds. There would then be a substitute for the thing sold, upon which the lien would attach, relieving the land in the hands of the purchasers. But it could not have been the intention of the court to make a constructive payment on a purchase by the mortgagees, through a cancellation of the mortgage debt, equivalent to an actual payment, so as to relieve the property from the charge. Such a lien would be illusory merely, having no substantial quality. The purchasers cannot claim to have the premises purchased discharged from the lien."

[2] Mercantile Trust Co. *v.* Kanawha, & Ohio Ry. Co., (1892) 50 Fed. Rep. 874. The lien of receiver's certificates was enforced in an independent suit in Swann *v.* Clark, 110 U. S. 602; s. c., 4 Sup. Ct. Rep. 241.

struction of a railroad, and the president of which was a stockholder in the railroad company, and largely interested as a contractor in the construction of the railroad, equipped the railroad with rolling stock, and caused the same to be marked with the name of the railroad company; the improvement company's intent was to enable the company to issue certain bonds, secured by mortgage on its railroad as an equipped road, and such bonds were issued and placed through the instrumentality of the president of the improvement company. This was a suit by a holder of the bonds to foreclose that mortgage, and an assignee of the improvement company intervened, claiming the rolling stock. The Court of Appeals held that the improvement company and its assignee were estopped to allege that the transaction in question constituted a gratuitous loan of the rolling stock, or to deny the title of the railway company thereto, as against the bondholders.[1] The original vendor of this rolling stock, who, by his contract of sale to the improvement company, reserved title to the rolling stock, until payment of the purchase money, intervened in the same suit for foreclosure of the railroad mortgage on the railroad and its equipments which the improvement company had enabled the road to execute, as well as to negotiate its bonds. It was held by the same Court of Appeals that this original vendor of the rolling stock, having no notice of equities existing between the purchasers of the bonds of the railroad company and the improvement company, was entitled to the possession of the rolling stock, the title to which he had retained. But in such case, the improvement company, being estopped from setting up title against the bondholders by the fact that the bonds of the railroad company were placed through its instrumentality, the original vendor could take nothing by a resale to him by the improvement company of such rolling stock.[2] The rule was

[1] Central Trust Co. of New York v. Marietta & N. G. Ry. Co. (Hiawassee Co., Intervener), (1891) 48 Fed. Rep. 850, reversing Central Trust Co. of New York v. Marietta & N. G. Ry. Co. (Hiawassee Co., Intervener), (1891) 48 Fed. Rep. 32.

[2] Central Trust Co. of New York v. Marietta & N. G. Ry. Co. (Groome, Intervener), (1891) 48 Fed. Rep. 864, ordering the receiver to pay this vendor within a certain date the balance due him, or, if he was unable to pay, to deliver the property to him. There was a similar ruling in Central Trust Co. of New York v. Marietta & N. G. Ry. Co. (Jackson & Woodin Mfg. Co., Intervener), (1891) 48 Fed. Rep. 865, where there was a conditional sale to the improvement company of rolling stock.

declared by the United States Circuit Court of Appeals, in a case of foreclosure of railroad mortgage, where an intervener, who had furnished cars under a contract of conditional sale to the railroad company, and was held entitled to be paid balance of unpaid purchase money by the receiver, and the value of the rolling stock had been increased ten per cent since the same was furnished by him, that, in determining the sum which the receiver was to pay in order to retain possession of the rolling stock, ten per cent should be added to the cost thereof before deducting a percentage per annum for wear and tear.[1] The mortgage which was being foreclosed in this case covered "all after-acquired" as well as existing property of the railroad company, and was duly recorded. After its execution the railroad company purchased certain cars from a carbuilder, under an agreement by which the carbuilder retained title to the cars until they should be fully paid for, which agreement was in writing, but was never recorded. In the action for foreclosure of the mortgage the carbuilder intervened, claiming the cars under his reservation of title. The trust company foreclosing, opposed his claim, relying upon the effect of the statutes of Georgia concerning conditional sales. The United States Circuit Court of Appeals for the fifth circuit held that the trust company was not a third party within the meaning of the Code of Georgia, section 1955a (Laws 1881, p. 143), providing that, in order to retain title to personal property sold and delivered, as against third parties, "title must be reserved in writing, and the paper duly executed and recorded as a mortgage on personalty," and that the trust company could derive no advantage from the carbuilder's failure to record his reservation of title, as the statute was intended only for the benefit of subsequent purchasers and creditors of the vendee. Nor were the rights of the carbuilder affected as against the trust company, by the later statute of Georgia, which validates conditional sales of rolling stock to railroad companies with reservation of title, but requiring that such reservation shall be in writing, and shall be recorded within six months after the execution thereof, as that act was also intended only for the benefit of third parties, and operated to repeal the statute of 1881 no further than to provide a different method for the execu-

[1] Central Trust Co. of New York v. Marietta & N. G. Ry. Co. (Jackson & Sharp Co., Intervener), (1891) 48 Fed. Rep. 875.

tion of contracts for the conditional sale of railroad equipments.[1] It has been held by the United States Circuit Court of Appeals for the fifth circuit, in a suit for foreclosure of a railroad mortgage, that the statute of the state of Georgia, validating contracts for the sale of rolling stock made or to be made to the owner or operator of a railway within the state of Georgia, with reservation of title, and requiring such contracts to be recorded within six months after execution, had no application to such a contract, made before the passage of such act, by two foreign corporations, outside of the state, for the sale of rolling stock to be used within the state of Georgia, neither corporation being the owner or operator of a railway in the state.[2] The claim for rental of a leased line by the lessee company was pressed against the receivers of a railroad company of the system of which the leased line formed a part. This rule was declared: That the receivers of the system could not set off as against the claim for rentals accruing to the leased line during the receivership any cross-demand alleged to have accrued to the lessee prior to the receivership as the two claims arose in different rights. Further, in such case it was immaterial that the lessor was insolvent, when the lease provided for an arbitration of the matters claimed as a set-off, and expressly declared that the pendency of such arbitration should not interfere with the operation of the lease, and that all payments and transactions under the lease should continue exactly as if no controversy had arisen.[3] Where an insolvent railroad company, upon its own petition, procured the appointment of receivers to take possession of its road and leased lines, and in the same suit trustees of a mortgage asked, and were denied, an appointment of receivers, or an extension of the receivership under their cross-bill, but obtained a decree of foreclosure and a sale of the property thereon, it was held in the federal court that the rentals of the leased lines while in the possession of the receivers did not become a charge upon the *corpus* of the property to be paid in preference to the mortgage debt.[1] In a case in the United States Circuit Court for the northern district of Illinois, upon the intervention of a car company in a foreclosure suit brought by bondholders claiming rental for cars furnished to the company prior to the receivership, and to the receiver as they claimed after his appointment, Mr. Justice HARLAN declared this rule: On foreclosure of the railroad mortgage in this case, and the adjustment of claims of intervening creditors, the contract of lease of cars to the mortgage company, by the car company, dominated by the same persons, cannot be made the basis of an accounting for the use of the leased cars.[2]

[1] Central Trust Co. of New York *v.* Marietta & N. G. Ry. Co. (Groome, Intervener), (1891) 48 Fed. Rep. 868.

[2] Central Trust Co. of New York *v.* Marietta & N. G. Ry. Co. (Jackson & Woodin Mfg. Co., Intervener), (1891) 48 Fed. Rep. 865. As to claims against receivers for the rental of cars, see Farmers' Loan & Trust Co. *v.* Chicago & A. Ry. Co., 42 Fed. Rep. 6; Kneeland *v.* American Loan & Trust Co., 136 U. S. 89; s. c., 10 Sup. Ct. Rep. 950.

[3] Farmers' Loan & Trust Co. *v.* Northern Pac. R. Co. (Wisconsin Cent. Co., Intervener), (1893) 58 Fed. Rep. 257.

§ 552. Application of earnings of the road during receivership.— Where the road of a railroad company, on application of second mortgagees, is placed in the hands of a receiver, after it has purchased on credit rails which were necessary for the purpose of keeping its road going, it has been held that the seller of the rails had an equitable right, as against the second mortgagees, to have the earnings of the road in the hands of the receiver applied first to the payment of his claim; but he had no such right against the first mortgagees, even though they had filed cross-bills in the suit, since they were not the ones who applied to the court of equity, and might, therefore, stand on their legal rights.[3]

[1] Central Trust Co. *v.* Wabash, St. L. & P. Ry. Co. (Swayne, Intervener), (1891) 46 Fed. Rep. 26.

[2] Thomas *v.* Peoria & Rock Island Ry. Co. (Western Car Company, Intervener), (1888) 36 Fed. Rep. 808. This was a foreclosure suit by bondholders, and, among other defenses of the petitioner to this intervention was that the controlling directors of the railroad company organized this car company for their own benefit, and, therefore, contracted with themselves, with intent to injure the bondholders. Upon this defense, the rule in the text was declared.

[3] Bound *v.* South Carolina Ry. Co., (1891) 47 Fed. Rep. 30. The reasoning of SIMONTON, J., to sustain his ruling, was as follows: "The Supreme Court has established that a railroad mortgage, so long as the road is kept a going concern, is a peculiar piece of property. The holder of a bond secured by such a mortgage takes it with notice that the earnings of the railroad, notwithstanding that they may have been specially pledged for his debt, must first be applied to the current expenses, labor, supplies, equipments and such permanent improvements as are absolutely necessary before they can be used for the payment of his interest. And, if perchance he be paid, leaving these or any of them unpaid, this would be a diversion of the fund, and a person holding any such exceptional claim has an equity under certain circumstances to be reimbursed by having such diversion corrected out of the income in the hands of the com-

Here a ferry company had a contract, by which a railroad company was to have the use of certain lands as approaches to the ferry, and on its part agreed to transport all of its freight and passengers over the ferry of this company, which was over a navigable stream. The railroad company, becoming insolvent, a mortgage it had given was foreclosed; it having been first placed

pany, and, if in the meantime a receiver has been appointed, out of the earnings in the hands of the receiver. This is an equity founded upon the doctrine that the officers of a railway company are trustees, or, perhaps, we should say, the recipients and holders of a trust fund, applicable first to claims of this character and after them to the interest on the mortgage debt. The origin and reason for this equity are found in the fact that a railroad is of public concern and must be kept up. Those who contribute to keep it up and so subserve the public weal are rewarded. This equity is enforced wherever suit is brought by the mortgagee to enforce his mortgage and is held superior to the legal lien of the mortgage. This doctrine was first distinctly set out in Fosdick *v.* Schall, 99 U. S. 235, and is sustained by a current of authority. Miltenberger *v.* Railway Co., 106 U. S. 286; s. c., 1 Sup. Ct. Rep. 140; Trust Co. *v.* Souther, 107 U. S. 591; s. c., 2 Sup. Ct. Rep. 295; Burnham *v.* Bowen, 111 U. S. 776; s. c., 4 Sup. Ct. Rep. 675. It seems to have been shaken in Kneeland *v.* Trust Co., 136 U. S. 89; s. c., 10 Sup. Ct. Rep. 950; but in Kneeland *v.* Foundry, etc., Works, 140 U. S. 592; s. c., 11 Sup. Ct. Rep. 857, the court quotes with approval Fosdick *v.* Schall and the authorities following it and reaffirms them. The only qualification laid down is that this equity is put in motion as to such claims only as arose within a reasonable time before the receiver was appointed. The term 'a reasonable time' is an unknown, or, perhaps, an uncertain quantity; at least it depends somewhat on the circumstances of the case and somewhat on the idiosyncracies of the chancellor. See Paine *v.* Railroad Co., 118 U. S. 159; s. c., 6 Sup. Ct. Rep. 1019. One of the cases fixes the limit at ninety days. Miltenberger *v.* Railway Co., 106 U. S. 288; s. c., 1 Sup. Ct. Rep. 140. In Thomas *v.* Railway Co., 36 Fed. Rep. 817, six months is selected as the limit. Judge BREWER, in Blair *v.* Railway Co., 22 Fed. Rep. 471, says that six months is the longest time within his knowledge that has ever been given. In the present case eighteen months elapsed between the purchase of the rails and the appointment of the receiver. But, as we have seen, this claim on the part of a materialman is protected by an equity. The officers of the company hold the earnings as a trust fund in which claims of this character have a preference. The payment of interest to bondholders, these material claims being unpaid, is held to be the use of money belonging to them for the benefit of others, and the diversion of the fund entitles them to recoup. It is difficult under these circumstances to see how any creditor of this class can be defeated in his application for reimbursement unless in analogy to the Statute of Limitations, or unless such circumstances exist as will induce the court to treat it as a stale claim, or unless he has lost an opportunity of recovering his debt from the company, or unless his *laches* has operated some change in the position of the mortgage creditor. At the time

in the hands of a receiver, its property was purchased by another railroad company, and this latter, having executed a mortgage securing bonds, becoming insolvent, a suit for foreclosure was instituted upon this mortgage and a receiver was appointed for its property. The purchaser of the property of the original contracting railroad company in part continued this contract with the ferry company, and so also did the receivers under the different foreclosures. The ferry company intervened in this last foreclosure suit and claimed that it should be, besides other relief asked, paid for certain rails which had been removed from the land by the receiver. The United States Supreme Court held that the ferry company was not entitled to recover the value of the rails removed by the receiver.[1] In a foreclosure suit involv-

this debt was incurred the whole railroad property, present and future, was covered by a statutory lien, by a first mortgage, a second mortgage and an income mortgage. The rails were absolutely necessary to keep the road a going concern. The Lackawanna Company furnished these rails, trusting to the statement of the president of the railway company that they would be paid out of the earnings. These belonged to the company (Fosdick *v.* Schall, *supra*), and the president could so dispose of them. The authorities quoted show that the Lackawanna Company belongs to a class of creditors who had an equity over these earnings even as against bondholders. When the notes first matured the railroad company had defaulted on its April and October interest of the second mortgage bonds. No action in the court on the part of the Lackawanna Company could have collected its claim. By pressure on the company it was paid one note. But, as the end of the struggle of the railroad company was inevitable, the Lackawanna Company had the right to rely upon its equity and to look for payment out of the diverted funds. It seems to me that this claim comes within the principle and the protection of Fosdick *v.* Schall."

[1] Wiggins Ferry Co. *v.* Ohio & Mississippi Ry. Co., (1892) 142 U. S. 396. It was said in the opinion: "In the case of Wagner *v.* Cleveland & Toledo Railroad, 22 Ohio St. 563, it was held that the stone piers built by a railroad company as part of its road on lands over which it had acquired the right of way, did not, though firmly imbedded in the earth, become the property of the owner of the land, as part of the realty, and that, upon the abandonment of the road, the company might remove such structures as personal property. So, in Northern Central Railroad *v.* Canton Co., 30 Md. 347, it was held that rails fastened to the roadbed of a railroad, as well as the depots and other buildings, might, under certain circumstances, be treated as trade fixtures, and removable by the company, if the surrounding circumstances showed that at the time the rails were laid upon the land, it was not intended that they should be merged in the freehold. In that case the road was built upon land under a license and permission of the owner. It is entirely clear that the suits in the case under consideration did not become part of the realty, and that the receiver was not guilty of waste in removing them from the land." When preferred debts for labor and

ing the mortgage of a street railway company, the United States Circuit Court for the northern district of California refused to direct the receiver to pay out money in his hands for the purpose of grading and macadamizing the street along and between the rails, in accordance with an order of the town trustees upon the ground that there was no lien in favor of the town for such an expenditure.[1] A railroad company operating a system of leased roads through several of the states was placed in the hands of a receiver in the federal court for the eastern district of Virginia. One who had furnished materials that were used in the roadbed of one of these leased roads which was operated as part of the system of the lessor road, proceeded in the state court against the lessor road

materials furnished, for the operation of a division of a system of railroads owned by a railroad corporation, are a lien upon the earnings of all the roads of the system prior to underlying and general mortgages, see Central Trust Co. *v.* Wabash, St. Louis, etc., Ry. Co., 30 Fed. Rep. 332. When the earnings of a system of railroads in the hands of a receiver may be expended in a greater proportion on some of the liens than on others, if necessary to the prosperity of the whole system, see Central Trust Co. *v.* Wabash, St. Louis, etc., Ry. Co., 30 Fed. Rep. 332. When a receiver should pay coupon bonds overdue in preference to coupons of bonds issued under a mortgage of a prior date, see Park *v.* New York, Lake Erie & Western R. R. Co., 64 Fed. Rep. 190. When a receiver will not be directed to pay out of the earnings in his hands interest on bonds secured by mortgage on a part of the road, merely to avoid foreclosure proceedings of the mortgage, see Cleveland, C. & S. R. R. Co. *v.* Knickerbocker Trust Co., 64 Fed. Rep. 623. That coal used in operating a road before and after receivership, should be paid for out of the surplus where income is insufficient, see Clark *v.* Central R. R. & Bkg. Co. of Georgia, 66 Fed. Rep. 803; s. c., 14 C. C. A. 112. When a receiver will be compelled to restore funds diverted by paying earnings to interest on bonds for the purpose of payment of taxes on property in his hands, see Clyde *v.* Richmond & Danville R. R. Co., 63 Fed. Rep. 21. For a declaration of rules by Mr. Justice HARLAN as to what is chargeable to income during receivership, see Thomas *v.* Peoria & Rock Island Ry. Co. (Western Car Co., Intervener), (1888) 36 Fed. Rep. 808–818; citing Fosdick *v.* Schall, 99 U. S. 235, 252–254; Milterberger *v.* Railway Co., 106 U. S. 286, 311, 312; s. c., 1 Sup. Ct. Rep. 140; Trust Co. *v.* Souther, 107 U. S. 591; s. c., 2 Sup. Ct. Rep. 295; Trust Co. *v.* Railway Co., 117 U. S. 434; s. c., 6 Sup. Ct. Rep. 809; Burnham *v.* Bowen, 111 U. S. 776; s. c., 4 Sup. Ct. Rep. 675; Trust Co. *v.* Morrison, 125 U. S. 591; s. c., 8 Sup. Ct. Rep. 1004; Railroad Co. *v.* Cowdrey, 11 Wall. 459; Gilman *v.* Telegraph Co., 91 U. S. 603; Bridge Co. *v.* Heidelbach, 94 U. S. 798; Sage *v.* Railroad Co., 125 U. S. 361; s. c., 8 Sup. Ct. Rep. 887; Trust Co. *v.* Shepherd, 127 U. S. 494; s. c., 8 Sup. Ct. Rep. 1250.

[1] Union Loan & Trust Co. *v.* Southern Cal. Motor Road Co., (1892) 49 Fed. Rep. 267.

and reduced his claim to judgment, after the lease was annulled as to this leased road. Pending the action, the receivers were appointed for the whole system. As to this judgment, it was held in the federal court for the district of South Carolina, where this intervention was made, that the judgment could not operate as a judgment against the receivers, nor bind the realty in their hands, it not having been in existence when they were appointed. A question was raised as to the jurisdiction of this intervention, as the intervener prayed of the court sitting for South Carolina, that his claim be paid out of income in preference to any mortgage lien, as being for materials that had assisted in keeping the system a going concern. The receivers of the lessor road were originally appointed in Virginia, and by these ancillary suits in the different states their authority was extended and confirmed. SIMONTON, D. J., of the United States Circuit Court for South Carolina, held that the court which originally appointed the receivers was the forum in which the claimant should seek relief. But, as he regarded the claim a meritorious one, he did not order the petition before him dismissed, but retained it, in order, if possible, to assist the petitioner in enforcing its payment.[1]

§ 553. Jurisdiction of actions against receivers.— The act of congress of 1887–1888, permitting receivers of railroad corporation property to be sued for acts or transactions of theirs in carrying on the business connected with the property, without leave of the court appointing them, does not confine those bringing the suits to the courts having jurisdiction of the receiver and the property, or to the federal courts generally. They may be sued, without such leave of court, in any court of competent jurisdiction. Neither is there any power in the court appointing them to enjoin the bringing of such suits in such other courts of competent jurisdiction.[2] But garnishment proceedings have been

[1] Clyde *v.* Richmond & Danville R. Co., (1893) 56 Fed. Rep. 539; Ex parte Powell, (1893) 56 Fed. Rep. 539.

[2] Central Trust Co. of New York *v.* East Tennessee, V. & G. Ry. Co., (1894) 59 Fed. Rep. 523. LURTON, Circuit Judge, after referring to cases prior to the passage of this act of congress, such as Davis *v.* Gray, 16 Wall. 218; Barton *v.* Barbour, 104 U. S. 126, and others, said, *arguendo:* "Whether it was the intention of congress to permit receivers appointed by, and accountable to, United States courts to be sued with respect to acts and transactions as such receivers in courts of

held not to be suits against the receiver for "any act or transaction of his," within the meaning of that act of congress, and the court appointing the receiver, it was also held, might enjoin the bringing of such proceedings, as well as suits upon causes of action originating before the receivership, and all other suits not arising from some act or transaction of the receiver in carrying

other jurisdictions, is by no means clear. Under the law as it stood the court, having custody of the property *pendente lite*, had exclusive jurisdiction of all suits affecting such property, and drew to itself complete jurisdiction with respect to all the acts and transactions of the receiver in maintaining or operating property so sequestrated. It was just as much a contempt of court to institute a suit affecting such property or its custodian, as such, in the court of his appointment, without previous leave of court, as it was to bring such suit in another jurisdiction. A judgment against the receiver is a judgment against the receivership. It is a judgment affecting the property and to be paid therefrom. To properly administer a sequestrated property the liabilities should be determined in due course and the claims ranked, and the property marshaled and distributed according to legal or equitable priorities. The act might well have been construed as only permitting suits in the court having jurisdiction of the property and the receiver. This would have secured to the suitor the right of jury trial, according to the usual course of the court, where the demand was of legal character. At the same time such judgment would have been subject to the equitable jurisdiction of the court, and be given its proper rank in the distribution of the property. There is much force in the argument that, in view of the previous exclusive jurisdiction of the court appointing the receiver over him and over the sequestrated property, a construction ought to be given this act which would have preserved the equitable jurisdiction of the Circuit Courts over property in *custodia legis*, and over suits affecting it. We, however, feel precluded from now placing such a construction upon the act in consequence of the decisions of the Supreme Court of the United States in McNulta *v.* Lochridge, 141 U. S. 327; s. c., 12 Sup. Ct. Rep. 11; Railway Co. *v.* Johnson, (1894) 14 Sup. Ct. Rep. 250. * * * If that act authorized a suit against a receiver in a state court, without leave of the court appointing the receiver, in respect to a liability incurred while carrying on the operation of a railroad as a receiver under a decree of a United States Circuit Court, as was held in McNulta *v.* Lochridge, *supra*, then a right of suit thus conferred by congress cannot be restricted in advance of its exercise. This would be, in effect, to nullify the act of congress, and, therefore, in excess of jurisdiction. The power given by the proviso ["but such suit shall be subject to the general equity jurisdiction of the court in which such receiver or manager was appointed, so far as the same shall be necessary to the ends of justice"] must not be so construed as to authorize the courts to prevent that which congress has expressly provided may be done. That it was intended by congress that some meaning should be attached to the very significant proviso [above quoted] is most obvious. It was not intended that the rights to litigate with the receiver in any court should be an unrestrained right. Whether the proviso should be limited so as to give the court appointing the receiver power upon equitable grounds and upon special application to restrain proceedings in a pending suit brought without leave of the court, or whether, after judgment, the court would exercise its equitable jurisdiction by inquiry into the judgment, in order to determine its justice or its place and rank in the distribution of the property out of which it is to be paid, are questions which need not now be settled. A wide difference of opinion has been entertained as to the power of the court over property obtained against the receiver in courts other than that appointing the receiver. Central Trust Co. *v.* St. Louis, etc., Ry. Co., 40 Fed. Rep. 426; Eddy *v.* Wallace, 49 Fed. Rep. 801; s. c., 1 C. C. A. 435; Missouri Pac. Ry. Co. *v.* Texas Pac. R. Co., 41 Fed. Rep. 311. In the two cases first cited it was held that such judgments were conclusive. In the case reported in 41 Fed. Rep. 311, it was held that it was within the power of the court when such judgments were filed in the case in which the fund was being distributed to look into them and allow the whole or half or any part as justice might require. The latter view seems to have been entertained by Mr. Justice JACKSON, for, while judge of this circuit, he made an order in this cause, which has not been revoked,

on the business connected with the property in his charge.[1] The Supreme Court of Minnesota has held that an indebtedness incurred by the receivers of a railway company appointed by the federal court, while operating the road under the authority of the court, may be garnished in a state court. But no executory process can be issued against the receivers on the judgment rendered therein. It can only be satisfied, as other demands are satisfied, by an application to the court in which the receivership proceedings are pending for an order directing its payment.[2] In a case

requiring all judgments in other courts, obtained in suits prosecuted without leave of the court, to be filed by intervening petition in the main cause, together with a full bill of exceptions showing the evidence upon which the judgment rested. That the judgment is conclusive so far as to be regarded as a judicial ascertainment of liability and of the amount is probably the better view. Speaking of the effect of the proviso, the learned chief justice, in the case of Railway Co. *v.* Johnson, *supra*, said that 'the right to sue without resorting to the appointing court, which involves the right to obtain judgment, cannot be assumed to have been rendered practically valueless by this further provision in the same section of the statute which granted it.'"

[1] Central Trust Co. of New York *v.* East Tennessee, V. & G. Ry. Co., (1894) 59 Fed. Rep. 523.

[2] Irwin *v.* McKechnie, (Minn. 1894) 59 N. W. Rep. 987: MITCHELL, J., for the court, said: "No question is made, nor could well be, but that, under the 'Removal Act' of March 3, 1887, the receivers are subject to suit in respect to any transaction of theirs in operating the road, the only point made being that the money sought to be reached was *in custodia legis*, and hence not subject to garnishment. No one will question the correctness of

in the United States Circuit Court for the southern district of Iowa, the receiver of a railroad and its property appointed by that court applied to the court for an order and writ of injunction, with reference to garnishment proceedings about to be brought in the state courts to reach wages of his employees in his hands. The court, while hesitating to attempt a process of injunction which might in any event or to any degree affect actions pending or about to be brought in the courts of the state, did direct its receiver, upon service of notice of garnishment upon him, as receiver, in the state courts, to file with the officer serving the process an uncertified copy of an order made by the court, and thereafter to take no further part, as such receiver, in the action. The order referred to was finally to the effect "that if any plaintiff or claimant in or under said garnishment action, notice, writ or process shall thereafter further proceed therewith in said state court, such plaintiff or claimant shall not be granted leave nor allowed to file in this court any application or claim for payment of or with reference to said claim so set up in said state court or judgment thereon (if any rendered thereon), nor shall he be decreed or permitted to receive therefor from said receiver or through this court, in any manner, any wages or funds that at any time may be in the hands of said receiver, which may be due or belong to any alleged debtor in

the proposition that property in the hands of receivers appointed by the court is *in custodia legis*, and not subject to levy or garnishment. This doctrine receives additional force in this case from the rule of judicial comity between state and federal courts, by which each will refuse to interfere with property in the custody of the other, a rule which we are always solicitous to observe. But in this case it will be noticed that what is sought to be reached by garnishment is the property, not of the railway company, but of the defendant, viz., a debt due from the receivers. Moreover, while garnishment of a debt is often called a mode of attachment, yet it does not effect a specific lien on any property. The effect of the judgment is merely to determine the existence and amount of the debt, and to substitute the plaintiff for the defendant as the person to whom it is payable. The judgment against the receivers would not be against them personally, but against them officially. No executory process could be issued on it, for that would interfere with the control of the property in the custody of the federal court. The manner in which the judgment so rendered shall be paid must be under the exclusive control of that court. It can only be satisfied as other demands may be satisfied, viz., by an application to the court in which the receivership proceedings are pending for an order directing its payment in the due order of the settlement of the affairs of the insolvent company by that court."

such garnishment proceedings, nor the payment of any costs in such proceedings incurred."[1]

§ 554. Claims against receivers for injuries to persons or property during receivership.— Where a railroad was being operated by a receiver, the receiver, and not the railroad company, has been held liable, under the provisions of the Code of Iowa, for the value of stock injured on the railroad company's unfenced right of way through the negligence of the railroad employees. And in such a case the service of notice in due form of a claim for damages for an injury to stock upon the receiver and a station agent in the county where the stock was injured was held sufficient, under that provision of the Code, to entitle the claimant to recover double damages for another injury, if payment was not made within thirty days after the service of such notice.[2] Another action for damages of a similar kind was

[1] In re Barnard; United States Trust Co. of New York *v.* Omaha and St. Louis Ry. Co., (1894) 61 Fed. Rep. 531. It was said by the court, as justifying such an order: "That the bringing of actions in the state courts by creditors of employees engaged in connection with said railway, to be accompanied with garnishment of the receiver, must necessarily be attended with trouble and expense to said receiver cannot be doubted. These actions, it is well known, are generally for small amounts, and are brought mostly before justices of the peace over widespread area and in any county in which, under the statutes of the state, service may be had. They thus become to the receiver a matter of serious inconvenience if not of possible hazard because of the judgments that may be therein rendered. But to our mind there is a consideration of a much more serious nature. The railway company is in the hands of this court. Its employees are in the service of this court. It is the duty of the court through its receiver and employees to maintain and operate said road as efficiently as practicable. The court recognizes that these employees are generally dependent for their living upon the wages contracted to be paid them for their labor upon and in connection with said railway. These garnishment proceedings are instituted for the purpose of collecting debts due to outside creditors, and the motive is to seize and appropriate these wages — the livelihood — of these employees for the payment of such debts. In other words, the wages of the employees of this court necessary for their present living are, in these garnishment proceedings, to be diverted from such use. The effect must be to diminish the power of this court to operate the road. To take away the support of the employees is to cripple the efficiency of such operation, and this court is not powerless to prevent its employees from being starved out of its employ."

[2] Brockert *v.* Central Iowa Ry. Co., (1891) 82 Iowa, 369. Whether in the action the railway company was a proper or necessary party, *quære*. As to the liability of receivers in such actions, see Beach on Receivers, §§ 721–

brought in the Texas courts against a receiver of the railroad property appointed by the United States Circuit Court and the railroad company which finally purchased the property from the purchaser at the sale under the receivership by order of the federal court. There was a judgment against the company, but in favor of the receiver. Upon the appeal of the company to the Court of Civil Appeals of Texas, this latter court held that the federal court, having exclusive jurisdiction of the property and assets of this railroad company, appointed a receiver therefor, and ordered that all claims against the railroad should be by intervention in the receivership proceeding before a certain date, the claim of the plaintiff here having occurred during the receivership, and not having been presented before the federal court within the time allowed, was barred.[1] On the ground that

723 and notes; Ohio & Mississippi Ry. Co. *v.* Davis, 23 Ind. 553; Memphis & L. R. Ry. Co. *v.* Stringfellow, 44 Ark. 322; Stephens *v.* Railroad, 36 Iowa, 327.

[1] Dillingham *v.* Kelley, (Tex. Civ. App. 1894) 27 S. W. Rep. 806. It was said by the court: "Under the general rules of law, as administered in courts of equity, a railroad corporation is not liable for damages sustained by the negligence of a receiver while operating the road except when the road is returned without sale to its owner with improvements made thereon by the receiver out of the earnings of the road while in his possession. If there be a sale of the property under decree of the court the purchaser takes it, together with whatever improvements may have been made by the receiver, free from all charges or burdens except such as may have been imposed by the decree, or such as may have existed prior thereto. In the case of Railway Co. *v.* Johnson, reported in 76 Tex. 421; s. c., 13 S. W. Rep. 463, and in 151 U. S. 81; s. c., 14 Sup. Ct. Rep. 250, and upon which appellee seems to rely, the property of the company was returned to it without sale, with large improvements made thereon by the receiver, and it was held by both the Supreme Court of Texas and the Supreme Court of the United States that a recovery against the defendant company was right; and it is to be noted that in the opinion delivered by each of these courts the fact that there was no sale of the property is emphasized. The Circuit Court in which the receivership was pending had exclusive jurisdiction of the property and assets of the railway company, and while the act of congress of 1887–1888 gives the right to any one aggrieved by a receiver to sue him in another court without first obtaining permission from the court in which the receivership is pending, the act expressly provides that the latter court is not to be deprived of or impeded in the exercise of its equity jurisdiction; and in the proper exercise of its powers the Circuit Court, by appropriate orders and the customary notices, took steps to provide for the payment of all just claims against either the receiver of the road or its property, and required all persons having claims to present the same to that court, within a reasonable time, for adjudication, and to that court the plaintiff should have applied for compensation for the alleged injury received through the negligence of the receiver. Neither the legislature nor the judiciary of a state can defeat or restrain the federal courts in the legitimate exercise of their jurisdiction. The act of the legislature of Texas of 1889, known as the 'Receivers' Act,' has no application to receivers appointed by the federal courts; and a judgment rendered by a state court against such receiver cannot be executed by the state court, but must be referred for payment to the federal court in which the receivership is pending.' See Fordyce *v.* Du Bose, (Tex.) 26 S. W. Rep. 1050.

it was just and good policy the federal courts have ordered receivers of railways under their control to pay wages of employees injured while employed on their lines of road during recovery from those injuries.[1] The intervener in this case, where a railroad was in the hands of receivers, was a baggagemaster claiming damages for an injury resulting from the negligence of other trainmen under the statutes of Kansas, which provide that "every railroad company organized or doing business in this state shall be liable for all damages done to any employee of such company, in consequence of any negligence of its agents, or by any mismanagement of its engineers or other employees." The United States Circuit Court of Appeals for the eighth circuit held that the right of the intervener under that statute was in no wise affected by the fact that the railroad was at the time in the custody of a receiver, and operated by him.[2] In an action against receivers the rule of the common law that the master is not liable to a servant for an injury sustained in consequence of the negligence of a fellow-servant. Does the fact that a receiver is appointed to temporarily operate a railroad forthwith alter the status of all of its employees, and re-establish as to them the old rule of the common law, so long as the receiver remains in charge? Viewing the question in the light of those circumstances of public policy, which probably gave birth to the statute, we cannot conceive of any reason why the appointment of a receiver should have such effect. It is a fact of which we may well take judicial notice that great railway systems, which employ thousands of men, are frequently operated for a term of years through the agency of a receiver. Such receivers do not, as a general rule, change the working force of the road, or the rules and regulations by which trains are run or by which the other business of the road is transacted. The men whom they employ are engaged in the same *quasi* public service as other railway employees and daily en-

[1] Missouri Pac. R. Co. *v.* Texas & Pacific Ry. Co., (1888) 33 Fed. Rep. 701; Missouri Pac. Ry. Co. *v.* Texas & Pacific Ry. Co., (1890) 41 Fed. Rep. 319.

[2] Hornsby *v.* Eddy, (1893) 56 Fed. Rep. 461, following Trust Co. *v.* Thomason, 25 Kans. 1. THAYER, D. J., speaking for the court, said: "It is clear that with respect to persons employed by a railway company as railway operatives the statute * * * changes

of a railroad company for damages to a crop of hay by fire caused by sparks from the locomotive engine, service was perfected upon the receivers by service upon a station agent in their employ. A motion made to quash the service was overruled and an exception served. Before the United States Circuit Court of Appeals for the eighth circuit it was contended that the lower court, on this state of facts, did not acquire jurisdiction to enter a judgment against the receivers. The Court of Appeals disregarded the contention for two reasons: *Firstly.* The 3d section of the Judiciary Act of March 3, 1887, authorizing suits to be brought against receivers of railroads, without special leave of the court by which they are appointed, was intended, as the court thought, to place receivers upon the same plane with railway companies, both as respects their liability to be sued for acts done while operating a railroad and as respects the mode of obtaining service.[1]

counter the same risks and hazards. Furthermore, the receiver of a railroad operates it for the immediate benefit of the company by which it is owned, in that he discharges all of the public duties of the corporation and appropriates the income of its road to the preservation of its property and franchises, and to the payment of its debts. In view of the fact that many railroads have been operated for years by receivers, and the manner in which it is customary to operate them, congress has recently recognized both the justice and expediency of placing such receivers on a plane with railway corporations, by declaring, in explicit language: 'That whenever in any cause pending in any court of the United States, there shall be a receiver or manager in possession of any property such receiver or manager shall manage and operate such property according to the requirements of the valid laws of the state in which such property shall be situated, in the same manner the owner or possessor thereof would be bound to do if in possession thereof; * * * and that every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed.' 24 U. S. Stat. at Large, 554; Eddy *v.* La Fayette, 49 Fed. Rep. 807; s. c., 1 C. C. A. 441. The general constructions warrant the conclusion that, if the rules of the common law are modified for the benefit of the employees of railway companies, either because of the extraordinary dangers to which they are exposed, or the *quasi* public nature of the service in which they are engaged, or for any other reason, then, for like reasons, the old rule of the common law should not be held applicable to the employees of a receiver who is engaged in operating a railroad, and we can scarcely conceive that any legislative body would intentionally make any distinction between the two classes of employees last referred to."

[1] Following and concurring in what was said in Central Trust Co. of New York *v.* St. Louis, A. & T. Ry. Co., (1889) 40 Fed. Rep. 426. CALDWELL, J., said in this case: "This act

Secondly. By answering to the merits and going to trial after the motion to quash the service had been overruled, the receivers submitted to the jurisdiction of the court, and should not be permitted to question its jurisdiction in this court.[1]

§ 555. Rules as to actions for injury to persons during receivership.— The United States Circuit Court for the district of South Carolina refused leave for an action for personal injuries sustained before the appointment of a receiver of a railroad company within its jurisdiction, upon the ground that such an action could not be maintained against the receiver, but must be brought against the corporation.[2] Actions are maintainable against

was intended to correct abuses that had grown up under the old practice, one of which was pointed out before the passage of the act, in the opinion of this court in Dow *v.* Railroad Co., 20 Fed. Rep. 267. The act abrogates the old rule on the subject of suing receivers. It is no longer unlawful to sue a receiver appointed by a United States court without leave of the court appointing the receiver. The court had had no discretion to say when its receiver may be sued. The act gives the right, without condition of qualification. It is a right not to be nullified, evaded or abridged. No conditions can be imposed in its exercise. The court must give effect to the act. It has no discretion to do anything else. * * * The road the receivers are operating under the authority of this court runs clear across the state, a distance of three hundred miles; but the receivers have established their office in St. Louis, Mo.; there they remain, and when sued cannot be found and personally served with process in this state. The right to sue the receivers necessarily carries with it the right to serve the required process to make the suit effectual. This is implied in the act. What is implied in an act is as much a part of it as what is expressed. Process need not be served on the railroad receivers personally. It would be impracticable to do so in many cases. It is impracticable in this case. The receivers, like the railroad company, can operate the road only through their agents, who must always be within the jurisdiction of the courts of the state in which the road is operated. For a court to permit its receivers to remain beyond the jurisdiction of the state courts, and refuse to give effect to service on their agents in the state would effectually preclude the citizens from suing them in the state courts, and would bar a complete nullification of the act of congress."

[1] Eddy *v.* La Fayette, (1892) 49 Fed. Rep. 807.

[2] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. R. Co., (1891) 46 Fed. Rep. 508; citing Davenport *v.* Railroad Co., 2 Woods, 519; Ex parte Brown, 15 S. C. 523. As to liability of receivers of railroad corporations for injuries to persons during the receivership, see Missouri, K. & T. Ry. Co. of Kansas *v.* Chilton, (Tex. Civ. App. 1894) 27 S. W. Rep. 272. As to what need not to be alleged in a complaint against receivers of a railroad company in an action for damages for injuries occurring while they were in possession, and the effect of the stat-

receivers for injuries to employees while operating the road, under the statutes of states making railroad corporations liable for such.[1] Negligence of a receiver in operating the railroad in his charge, under direction of the court appointing him, creates no liability for which the corporation will be liable.[2]

§ 556. Rules as to allowances to receivers for counsel and expenses of parties in actions where receivers are appointed — what will be allowed and what not.— Receivers are officers of the courts, entitled to apply to the court for instruction and advice, and permitted to retain counsel, the fees of which counsel being within the just allowances that may be made by the court. The allowance of counsel fees on behalf of a receiver is made to the receiver and not to the counsel. These allowances to a receiver for counsel are largely discretionary, and appellate courts have generally treated the action of the court in making allowances as presumably correct.[3] The compensation of attorneys for receivers is usually determined according to the circumstance of the particular case, and corresponds with the degree of responsibility and business ability required in the management of the affairs intrusted to them, and the perplexity and difficulty involved in that management.[4] In this foreclosure suit the bill alleged the

utes of Texas as to actions against receivers, see Yoakum *v.* Kroeger, (Tex. Civ. App. 1894) 27 S. W. Rep. 953. In Texas & Pacific Ry. Co. *v.* Gay, (Tex. Civ. App. 1894) 27 S. W. Rep. 742, where the court found that a receiver for a railroad situated wholly within the state of Texas was appointed by a Federal District Court of another state, through the collusion of the railroad company, the Court of Civil Appeals held that the receiver would be treated as the agent of the company, and on the discovery of the fraud the company might be substituted as defendant in an action for the death of plaintiff's husband, originally brought against the receiver, so as to avoid the bar of the Statute of Limitations.

[1] Rouse *v.* Harry, (Kans.) 40 Pac. Rep. 1007; McGhee *v.* Claridy, (Ga.) 22 S. E. Rep. 375.

[2] Howe *v.* St. Clair, (Tex. Civ. App.) 27 S. W. Rep. 800; Memphis & C. R. R. Co. *v.* Hoechner, 67 Fed. Rep. 456; s. c., 14 C. C. A. 469.

[3] Stuart *v.* Boulware, (1890) 133 U. S. 78.

[4] Stuart *v.* Boulware, (1890) 133 U. S. 78. See Trustees *v.* Greenough, 105 U. S. 527, 537, where the subject is considered. Cases declaring rules as to compensation to receivers, expenses of counsel, etc., out of the trust funds in the hands of the court appointing such receivers: Crumlish's Admr. *v.* Shenandoah Valley R. R. Co., (W. Va. 1895) 22 S. E. Rep. 91; Abbott *v.* Packet Co., 4 Md. Ch. 310; Magee *v.* Cowperthwaite, 10 Ala. 966; Gardiner *v.* Tyler, 3 Keyes, 505; Cowdrey *v.* Railroad Co., 1 Woods, 346; s. c., Fed. Cas. No. 3,293; Farmers' Loan & Trust Co. *v.* Central Railroad of Iowa, 8 Fed.

railroad company's insolvency and the insufficiency of its assets to pay the mortgage bonds. The validity of the bonds was contested by the company, and during the litigation the company moved the court to order the receiver to pay certain sums to the company's counsel for services rendered and to be rendered; also, to pay its office expenses and the salary of its secretary, claiming that such payments were absolutely necessary to maintain its corporate existence and enable it to defend. The United States Circuit Court held that as such bonds were *prima facie* valid the holders of the bonds were entitled to all the assets, and to make such payments would be to impair their vested rights.[1] In this foreclosure suit it appeared that the receiver of a railroad employed attorneys, who, after protracted litigation, much reduced the claims of a certain lienholder. Afterwards the property was sold subject to that lien, and the receiver was discharged. The purchasing company recognized the claim of those attorneys for fees, and made a payment on account. There was another receivership afterwards in foreclosure proceedings brought by one claiming under a lien created by the new company, the purchasing company above referred to. Upon a petition of those attorneys in these last proceedings for an allowance of counsel fees the United States Circuit Court for the district of South Carolina held that they had no claim as against the new receiver, or the funds in his hands, as their services had nothing to do with keeping the road a going concern; that the recognition of their claims by the purchasing company amounted to no more than a simple contract which was not entitled to priority to the vested liens created by that company. Neither did the fact that

Rep. 60; Central Trust Co. *v.* Wabash, St. L. & Pac. Ry. Co., 32 Fed. Rep. 187; French *v.* Gifford, 31 Iowa, 428; Stuart *v.* Boulware, 133 U. S. 78; s. c., 10 Sup. Ct. Rep. 242; Tutt *v.* Sand Hills Hotel Co., (Ga. 1894) 22 S. E. Rep. 196. For a case where it was held that it was in the power of the court to render a final decree fixing and allowing the compensation of the receiver, counsel fees and other charges and expenses of administration; that every party to the entire case was bound to take notice of the action of the court, and that it was too late at a subsequent term of the court to except to the decree or move to set it aside for mere error, see Clements *v.* Empire Lumber Co., (Ga. 1895) 22 S. E. Rep. 987.

[1] Union Loan & Trust Co. *v.* Southern California Motor Road Co., (1892) 51 Fed. Rep. 106. Denying the motion, the court cited Beach on Rec. §§ 376, 752, among other authorities as supporting its conclusion.

the services of these attorneys, by reducing the claim of a prior lienholder, incidentally benefited all subsequent lienholders constitute any ground of priority in the absence of any contract of employment by them.[1] The mortgage of a manufacturing corporation had been foreclosed by a decree, and a petition was made therein for allowance of attorney's fees. The trust deed or mortgage given to secure the bonds of the corporation provided for payment of the trustee's expenses upon a sale by him under the powers contained in the deed. The trustee had foreclosed by suit, a course which was probably necessary because of a prior foreclosure sale in the state court. The suit was brought on request of certain bondholders, and the trustee had refused to act except under a stipulation that he should not be liable for the attorney's fees. The United States Circuit Court for the northern district of Georgia on the petition held that the trustee was not entitled as a matter of right to have attorney's fees taxed.[2] A trust company, which has been compelled to come into court to collect from the receiver of a railroad company certain rentals justly due, cannot claim compensation for the services of its solicitors in procuring the order for payment, when such services were entirely for its own benefit, and not for the purpose of saving or adding to the fund which was to be distributed to the creditors in general.[3] There was a contention in this case that

[1] Bound *v.* South Carolina Ry. Co., Ex parte Mitchell, (1892) 51 Fed. Rep. 58. See Hand *v.* Railroad Co., 21 S. C. 162.

[2] Robinson *v.* Alabama & Georgia Manufg. Co., (1892) 51 Fed. Rep. 268, following Fowler *v.* Trust Co., 141 U. S. 384; s. c., 12 Sup. Ct. Rep. 1.

[3] Central Trust Co. of New York *v.* Valley Ry. Co., (1893) 55 Fed. Rep. 903. To support its claim for compensation the trust company relied upon Investment Co. of Philadelphia *v.* Ohio & N. R. Co., 46 Fed. Rep. 696, and Easton *v.* Railroad Co., 40 Fed. Rep. 189. The court distinguished these cases in these words: "In both these cases the party claiming compensation from the court was a trustee named in the mortgage foreclosed, upon whom, by virtue of that contract relation, certain duties devolved connected with the mortgages. In the [first case] the trustee, having declined to proceed with a suit of foreclosure, and that duty having devolved upon the complainant for himself and other bondholders, the court disallowed the claim of the trustee for compensation, but did allow compensation for the complainant; the trustee in that case had been made a defendant and his duties were merely nominal. No active service in his behalf was performed in executing the trust and bringing the fund into court available for distribution to the beneficiaries under the mortgage. In the [second case] compensation was allowed the trustees of the several mortgages in that case because it appeared from the report of the master, as reviewed by the court, that active duties had devolved upon those trustees, and that by virtue of their relation to the mortgage compensation was justly due them."

the receivers ought to have no say in the matter, because the claim was one which the receivers recognized to be just, as rentals for cars which they had in their possession and actual use, and because the receivers did not move in these proceedings, and the trust company was compelled to do so; therefore, counsel fees were due to it out of the fund to arise in the case. But the court held that it was not the duty of the receivers to proceed affirmatively and procure the allowance of every claim preferred against them.[1]

§ 557. Actions allowed a receiver for the protection and benefit of the property in his hands.— These rules were declared in a foreclosure suit against a railroad company in the United States Circuit Court for the district of South Carolina. A federal court has power to enjoin a sheriff from distraining property in the hands of its receiver to enforce the payment of a tax which is alleged to be illegal, especially where the property seized many times exceeds in value the amount of the tax. The mere fact that under the state statute authorizing sheriffs to distrain for non-payment of taxes "sufficient personal property of the party charged" to pay the tax, a sheriff, in order to collect a tax of $1,200, alleged to be due from the railroad receiver, had distrained property worth $10,000, much of which belonged to third persons, was held sufficient to require the interference by injunction of the court which appointed the receiver, regardless of any question as to the validity of the tax. While property in the hands of a receiver of a federal court is bound for the payment of state taxes in the same manner as any other property, still, should the receiver believe the tax to be invalid, it is his right and duty to apply to the court appointing him for pro-

[1] Central Trust Co. of New York *v.* Valley Ry. Co., (1893) 55 Fed. Rep. 903. It was said: "The receivers are the officers of the court, and the order appointing them states generally the nature of the claims which they are authorized to pay. The claim represented in the motion now under consideration was one which required the issuing of receivers' certificates, and for which affirmative action on the part of some one was necessary. It was no part of the receivers' duty to move affirmatively in this matter, but it is the duty of the creditor so to do. The same duty devolves upon every creditor having a claim against this insolvent railroad."

tection. And where, in his application to the court in such case for protection, his action is based on a prior decision of the court appointing him that the tax was illegal, the court should extend such protection by enjoining the sheriff and requiring the property to be restored to the receiver until the presumption of the soundness of such prior decision has been overcome.[1] The United States Circuit Court for the district of South Carolina entertained jurisdiction of a proceeding by receivers of a railroad company against the state railroad commissioners for relief against alleged unjust and unreasonable rates for freight transportation established by the commissioners over the objection that it was a proceeding against the state within the eleventh amendment to the Constitution of the United States, inhibiting the exercise of jurisdiction by federal courts in suits brought against one of the United States by citizens of another state.[2] The bill filed

[1] Ex parte Chamberlain, (1893) 55 Fed. Rep. 704. It was said in the opinion: "The research of counsel on both sides of this case has succeeded in finding five cases in which a receiver was driven to seek the protection of the court in the matter of taxation; all of them of persuasive authority; more of them of conclusive authority. A petition was filed by a receiver before Judge BREWER in Central Trust Co. *v.* Wabash, St. L. & P. Ry. Co., 26 Fed. Rep. 11, praying protection from the payment of a tax. It appeared that the only reason for the application was that it was inconvenient to the receiver to pay the tax, and that its validity was in no way questioned. The petition was rejected. But the learned judge shows distinctly his opinion that upon proper showing he would have entertained the petition. This is his language: 'In levying and collecting taxes the state is exercising its sovereign power. There should be no interference with its collection of these taxes in its prescribed and regular methods, even by a court having property in the possession of its receiver, unless it is first charged that the taxes are in some way illegal or excessive.' A bill was filed in Hewitt *v.* Railroad Co., 12 Blatchf. 452, by receivers to test the legality of a tax. It was heard by Mr. Justice BLATCHFORD, who entertained the question, discussed it in a long and elaborate opinion, and sustained the legality of the tax. The same receivers came before him again in Stevens *v.* Railroad Co., 13 Blatchf. 104, and asked relief from the same tax, because of some irregularity. Naturally and properly, it having been decided that the tax was legal, he dismissed the petition. As we have said, a receiver must pay all legal taxes, and the court will not interfere to protect him if he attempt to escape from such payment. In Georgia *v.* Atlantic & G. R. Co., 3 Woods, 437, Mr. Justice BRADLEY did interfere with the summary process of collecting taxes by the state, and in his well-considered and able opinion established the right of interference upon the highest grounds of public policy."

[2] Clyde *v.* Richmond & Danville R. Co., (1893) 57 Fed. Rep. 436. SIMONTON, D. J., said: "This case presents no question of penalties. The state is in no sense a party to the record or privy to the record. The constitutionality of the statute under which respondents act is not in issue. The learned counsel for the state admit that the declaration of this statute that the rates fixed by the commission shall be sufficient evidence that they are just and reasonable, does not preclude the courts from examining into the fact whether they are just and reasonable. Under the statute the respondents are authorized and directed to make just and reasonable rates for the transportation of freight. The petition alleges that certain rates made by them are neither just nor reasonable. In this issue the sovereignty of the state is in no way involved." See Railway Co. *v.* Dey, 35 Fed. Rep. 873.

here by the receiver of a railroad company's property in a foreclosure suit to have certain leases of property of the railroad company which had been assigned to defendants declared void, based on allegations that this property which was land belonging to the railroad company had been leased to a director of the company who held nearly all its stock, which had been assented to or ratified by the other directors, who held nearly all of its remaining stock, was dismissed, the federal court holding that the receiver could not contest the validity of the leases, he not representing creditors and no circumstances being alleged vesting in him equities to maintain such a suit or to question the lessee's rights.[1]

[1] Tyler *v.* Hamilton, (1894) 62 Fed. Rep. 187.

CHAPTER XXX.

PRIORITIES OF LIENS IN FORECLOSURE SUITS.

§ 558. Priorities of liens — general rules.
559. Debts contracted for construction.
560. Presumption as to preferential character of a claim.
561. Mechanic's lien as viewed by the United States Supreme Court.
562. Furnishers of supplies — Kentucky statutes construed,
563. The rule under Ohio statutes.
§ 564. Contractors — Tennessee statutes construed.
565. Furnishers of supplies — Virginia statutes on this subject construed.
566. Loans of money to corporation before receivership.
567. Claims for services rendered the corporation prior to the appointment of a receiver.
568. When cases are not properly removable to United States court from state court.

§ 558. Priorities of liens — general rules.— As a rule, statutory liens should be paid out of the proceeds of sale of mortgaged property before mortgage bonds and equitable liens payable from earnings after such bonds.[1] The claim of an owner of land for damages, resulting from the construction and maintenance on a street in front of his land of a railroad mounted on trestle work, has been held superior to the claims of mortgage bondholders.[2] It has been held that persons conveying a right of way in the state of Tennessee directly to a railroad company have a lien for the purchase price prior to that of the mortgage bonds of the railroad company.[3] A railroad company, after mortgaging its real estate, purchased from interveners rolling stock, to be paid for in installments, the vendors securing title in themselves until paid for. A receiver was appointed in a judgment creditor's suit, the mortgagees not objecting. The latter afterwards brought

[1] Blair *v.* St. Louis, Hannibal, etc., R. R. Co., 25 Fed. Rep. 232.

[2] Mercantile Trust Co. *v.* Pittsburgh & W. R. Co., 29 Fed. Rep. 734. A case holding certain equipment bonds of a railroad company, afterwards consolidated with other companies, to have priority to consolidated mortgage bonds, under the Ohio statutes, see Compton *v.* Wabash, St. L. & P. Ry. Co., (Ohio) 16 N. E. Rep. 110. When outstanding debts of one of the constituent companies consolidating should have priority over the debt secured by first mortgage bonds, see Spence *v.* Mobile & Montgomery Ry. Co., 79 Ala. 576. That a receiver's expenditures may be made a preferred claim, see Hale *v.* Nashua & Lowell R. R. Co., 60 N. H. 333.

[3] Central Trust Co. of New York *v.* Bridges, (1893) 57 Fed. Rep. 753.

suit to foreclose their mortgage. Before a decree, the cars were returned to the vendors. The United States Supreme Court held that the first receiver not having been appointed at the instance of the mortgagees, the vendors of the rolling stock were not entitled to have their claim for rental of the rolling stock during the first receivership paid in preference to the mortgage debt out of the proceeds of the real estate sold under the mortgage foreclosure. But they were entitled to have their rental, after the commencement of the mortgagees' foreclosure suit, paid in preference to the mortgage debt, the receiver having retained possession of it and used it for the benefit of the property mortgaged.[1] A priority of lien to the mortgage was claimed in a Virginia case of certain "car trust claims," under a statute of that state, which statute the Supreme Court of Appeals held to be unconstitutional as to that part of it including the furnishing of cars and engines to a railroad company. It was insisted before the court that, though the statute was invalid, the claims in question were privileged debts, entitling the claimants to superior equities to the mortgage creditors, according to the doctrine well established in this country that, when the current receipts of a railroad, which are always first applicable to the payment of its current debts, *i. e.*, debts for labor, supplies and the like, are used in paying the mortgage debt, or in strengthening or protecting the security, it is competent and proper for a court of equity, when asked by the mortgagees to take possession of the road, and to hold and operate it for their benefit by the appointment of a receiver, to direct that the fund thus diverted be restored from the income of the receivership, or, under some circumstances, even from the proceeds of the sale of the *corpus* of the other property.[2] The court held that these "car trust claims" were not within the principles of the cases referred to, and were not entitled to any priority of lien to the mortgage.[3] The United States Supreme Court reversed the Circuit Court in this case, and

[1] Kneeland *v.* American Loan & Trust Co., 136 U. S. 89; s. c., 10 Sup. Ct. Rep. 950.

[2] See as to this doctrine, Fosdick *v.* Schall, 99 U. S. 235; Union Trust Co. *v.* Souther, 107 U. S. 591; Burnham *v.* Bowen, 111 U. S. 776; St. Louis, etc., R. R. Co. *v.* Cleveland, etc., Ry. Co., 125 U. S. 658, 673; Hale *v.* Frost, 99 U. S. 389; Williamson *v.* Washington City, Virginia Midland & Great Southern R. R. Co., 33 Gratt. 624.

[3] Fidelity Insurance Trust & Safe Deposit Co. *v.* Shenandoah Valley R. R. Co., (1889) 86 Va. 1.

held that a debt due from a railroad company to a car company for rental of cars prior to the commencement of the suit to foreclose a mortgage on the road and the appointment of a receiver was not a preferred debt, having priority over the mortgage debt.[1] In this case, the Supreme Court also reversed the court below in its allowance of interest on a claim for car rentals.[2] Where notes were given for money borrowed to pay interest on the bonded debt, with a stipulation in each note that a certain amount of the gross earnings of the road, from the date of the note, "is pledged in liquidation of this note," it has been held that the effect of the stipulation being ineffectual, these notes were not entitled to any priority of lien to the mortgage. But debts incurred by the company, within six months before the receivership, for construction of new road were held entitled to payment out of the net earnings of the receivership, in preference to mortgages executed before the road was finished, and showing

[1] Thomas *v.* Western Car Co., (1893) 149 U. S. 95, reversing Thomas *v.* Peoria & R. I. Ry. Co. (Western Car Co., Intervener), (1888) 36 Fed. Rep. 808. Mr. Justice SHIRAS, speaking for the court, after quoting largely from Miltenberger *v.* Logansport Ry., 106 U. S. 286, and Kneeland *v.* American Loan Co., 136 U. S. 89, 97, said: "Tested by the principles asserted in these cases, the claim for car rental that had accrued prior to the receivership cannot be maintained, but should have been disallowed. The case of a corporation for the manufacture and sale of cars, dealing with a railroad company, whose road is subject to a mortgage securing outstanding bonds, is very different from that of workmen and employees, or of those who furnish from day to day supplies necessary for the maintenance of the railroad. Such a company must be regarded as contracting upon the responsibility of the railroad company, and not in reliance upon the interposition of a court of equity. In the present case it appears, in the contract between the car company and the railroad company, that the former reserved the express right to terminate the contract and demand possession of the cars forthwith upon any failure by the railroad company to promptly pay the interest or the principal of any of its bonds or other liabilities. Such a provision shows that the car company was aware of the existence of the outstanding bonds, and protected itself by other methods than relying upon the possible order of a court which might appoint a receiver. Moreover, it appears in this case that the principal officers of the car company were in control of the railroad company and its operations, and must be treated as having full notice of the financial conditions of the railroad company, and as having leased the cars to it in reliance upon its general credit, rather than in expectation of displacing the priority of the mortgage liens."

[2] Thomas *v.* Western Car Co., (1893) 149 U. S. 95. They said: "As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. Williams *v.* American Bank, 4 Met. 317, 323; Thomas *v.* Minot, 10 Gray, 263. We see no reason in departing from this rule in a case like the present, where such a claim would be paid out of moneys that fall far short of paying the mortgage debt."

[1] McIlhenny *v.* Binz, (Tex.) 13 S. W. Rep. 655.

[2] Bound *v.* South Carolina Ry. Co., (1893) 58 Fed. Rep. 473. An illustration of where there was not such a diversion of earnings of a railroad from the operating expenses as not to give a preference for certain operating expenses over the bondholders out of the proceeds of a foreclosure sale: St. Louis, A. & T. H. R. Co. *v.* Cleveland, C. & C. I. Ry. Co., 8 Sup. Ct. Rep. 1011, following Railroad Co. *v.* Railroad Co., 6 Sup. Ct. Rep. 1094. In Porter *v.* Pittsburg Bessemer Steel Co., (1887) 120 U. S. 649, unsecured floating debts, due by the railroad company for construction, were, in the absence of statutory provision, held not to be a lien on the railroad superior to the lien of a valid mortgage on it, duly recorded, and of bonds secured thereby, and held by *bona fide* purchasers for value.

that it was contemplated that the road should be completed, and that the mortgages attached to the road as fast as completed.[1] It appeared in a foreclosure proceeding and interventions that a railroad company had purchased on a credit of eight months certain rails for its use, promising to pay for them out of its earnings. Only a part of the purchase money was paid at the end of the eight months, the notes for the balance being extended. Before the expiration of the credit thus extended the company had paid interest on certain mortgage bonds, borrowing the money for the purpose on its notes, which were afterwards paid out of its earnings. The receiver in this case was appointed eighteen months after the purchase of the rails. The holders of these notes given for the purchase of the rails claiming a priority to the mortgage out of the proceeds of the sale on foreclosure, it was held by the United States appellate court that the giving of the credit by the sellers of the rails to the company indicating an expectation that the interest on the bonds becoming due in the meantime would be paid, the payment of this interest was not a diversion of earnings within the rule giving a preference, on foreclosure, to current expenses incurred on the faith of earnings shortly before the appointment of a receiver.[2] The United States Supreme Court has held that a liquidated claim against a railroad company, not converted into a judgment, which another railroad company, purchasing its road and property, agreed with the selling company to assume and pay as part of the consideration, did not thereby become a lien upon the property so as to

take priority over the lien of a mortgage made by the purchasing company to secure an issue of bonds.[1] These facts appeared in a case before the United States Circuit Court of Appeals for the sixth circuit: Under the authority of the Michigan statute a railroad corporation sold all its property and franchises to another corporation and this latter mortgaged the same to secure an issue of bonds. A minority stockholder in the former corporation, who had dissented on the question of selling, brought an action against both of the corporations to set it aside, in which action a decree was made upholding the sale, but providing that this minority stockholder, on tendering his stock to the purchasing company, should have a right to receive an equal number of shares in the latter, or to have an execution against the corporation for the value of his stock. He elected to have the execution, and asked that it be declared a prior lien to the mortgage, but this the court denied him. In a suit brought subsequently to foreclose the mortgage executed by the purchasing corporation, he intervened, claiming an equitable lien prior to the mortgage for the value of his stock. The Court of Appeals held that the effect of the decree in his action to set aside the sale was to convert him from a stockholder in the selling corporation to a judgment creditor of the purchasing corporation, and that he had no lien as claimed.[2] In a case in a federal court it was held that a diversion by a railroad company of a fixed sum from the payment of claims for material used in keeping the road a going concern, to the permanent improvement of the road, or to the payment of interest on the bonds, must be made good by the bondholders, and the bondholders consented to make it good by the issue of receivers' certificates and the application of the proceeds to the claims. The materials here were held to be entitled to no further preference from the proceeds of the sale.[3] There having been a foreclosure sale in this case, and the property purchased by a committee of bondholders under a reorganization agreement, upon a distribution of the funds actually in court arising from such sale becoming necessary, there were various interesting rulings upon the various claims to this fund set up by the differ-

[1] Fogg *v.* Blair, (1880) 133 U. S. 534.

[2] Farmers' Loan & Trust Co. *v.* Toledo & S. H. R. Co., (1893) 54 Fed. Rep. 759.

[3] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (Pocahontas Coal Co., Intervener), (1892) 52 Fed. Rep. 524.

ent claimants. It was held upon its appearing that there might be claimants against the old company to an amount more than there was in the registry of the court, that the reorganization committee to whom a cash sale of the road was made and confirmed, and who failed to make good their bid, not for want of funds, but because they thought the price too high, could not be excused, on a resale of the property for a less price, from making good the difference, if the unsecured creditors would be benefited thereby. This reorganization committee, having in its hands a surplus of the bonds of one division of this company after paying in bonds the amount of the bid on that road, set up a claim that they were entitled to share in the distribution. Upon this claim it was held that when a reorganization agreement, to which all the bondholders and stockholders of the mortgagor company were parties, plainly showed an intention that the new securities to be issued after the purchase of the road at judicial sale should extinguish the old bonds for which they were to be exchanged, the consummation of the plan of reorganization operated as a payment of the old bonds, and the former holders of those bonds had no claim upon the proceeds of the sale, on the theory that they were to be regarded as unsecured creditors to the amount by which the sum realized fell below the amount of those bonds. Certain judgment creditors, whose original claims were for money advanced previously to the railroad company, having been included in the reorganization agreement on the same basis as the bondholders, were held to be in like position to the bondholders after the completion of the scheme by the delivery of the road to the new company as reorganized, and their claims were also to be considered as paid.[1] This reorganized railroad company had purchased and received possession of the road, and thereafter paid certain taxes and indebtedness incurred by the receiver in the foreclosure suit, without special authority from the court. Such payments, it was held, could not be regarded as loans to the receiver, to be reimbursed from the proceeds of the sale. The court further held that when, by the conditions of a railroad foreclosure sale, the court had required the payment in cash of an amount which was sufficient to meet all the allowed claims and

[4] Central Trust Co. of New York *v.* Cincinnati, J. & M. Ry. Co., (1892) 58 Fed. Rep. 500.

the expenses of the suit (the balance of the sale price being paid in bonds), the subsequent application, by consent of all parties, of part of the money paid in to liabilities not properly chargeable against it, amounted to a waiver by the owners of the allowed claims of their rights, to the extent that such an appropriation of the money reduced the ability of the fund to discharge their entire claims, with interest, and they could not afterwards require the purchasers to substitute sufficient cash in lieu of bonds to pay claims in full. And the receiver in this case, who resided at a distance from the property, and committed the active management of the railroad business to others, was not entitled to the full compensation usually paid to railroad presidents and receivers who are active executive heads of going railroads. He was allowed $2,500 per annum.[1] A claim against a railroad company for causing the death of plaintiff's intestate has been held to be a demand arising from a failure of duty, and one that could not, by its creation, benefit, preserve or increase the *corpus* of the estate of the company, and, therefore, not to be entitled to priority upon the foreclosure of a mortgage executed by such railroad company.[2] The owners of long-time railroad bonds, the company issuing them being solvent and having secured the bonds by mortgage of all its property, and promptly met all its coupons, guaranteed as to the principal and interest by a manufacturing corporation which subsequently went into the hands of a receiver, it has been held, could not prove the guaranty of the insolvent corporation and have a dividend declared thereon, or have money retained in court to meet a possible future liability on the guaranty, as against creditors of the insolvent corporation, who were pressing for a sale and distribution and who held either specific and general liens or demands past due.[1] The property of this railroad company had been sold under foreclosure proceedings and the proceeds of the sale were in court for distribution. One having a judgment obtained in a North Carolina court against the railroad company for injuries inflicted upon him, claimed priority to the bondholders in the distribution. His action had not been brought within sixty days after the mortgage was recorded. The Code of North Carolina, section 685, referring to corporations, provides as follows: "But any conveyance of its property, whether absolutely or upon condition, in trust, or by way of mortgage executed by any corporation, shall be void and of no effect as to the creditors of said corporation, existing prior to, or at the time of, the execution of said deed, and as to torts committed by such corporation, its agents or employees, prior to, or at the time of, the execution of said deed; provided, said creditors or persons injured, or their representatives, shall commence proceedings or actions to enforce their claims against said corporation within sixty days after their registration of said deed, as required by law." It was insisted that this section of the Code governed the case and that the judgment could not be given preference by reason of the action not having been brought within sixty days. The court, however, ordered that the claim be given priority to the bondholders, holding that the claim was protected by the Code of North Carolina, section 1285, which declares: "Mortgages of incorporate companies upon the property or earnings, whether on bonds or otherwise, hereafter issued, shall not have power to exempt the property or earnings of such incorporations from execution for the satisfaction of any judgment obtained in courts of the state against such incorporation for labor performed, nor for material furnished such incorporation, nor for torts committed by such incorporation, its agents or employees, whereby any person is killed or any person or property injured, any clause or clauses in such mortgage to the contrary notwithstanding."[1]

[1] Ibid.

[2] Farmers' Loan & Trust Co. *v.* Green Bay, W. & St. P. Ry. Co. (Franck, Intervener), (1891) 45 Fed. Rep. 664.

[3] Gay Manfg. Co. *v.* Gittings, (1892) 53 Fed. Rep. 45. When arrears of salary of a president of insolvent corporation will not have precedence in payment to a first mortgage deed out of the proceeds of a sale of the property, see National Bank of Augusta *v.* Carolina, K. & W. R. R. Co., 63 Fed. Rep. 25. When a receiver's right to reimbursement for improvements of the roadbed of a mortgaged road is subordinate to the mortgage lien, see Phinizy *v.* Augusta & Knoxville R. R. Co., 62 Fed. Rep. 771; Virginia Development Co. *v.* Crozer Iron Co., (Va.) 17 S. E. Rep. 806.

[1] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co., Ex parte Hudson, (1894) 61 Fed. Rep. 369; affirmed by U. S. Circuit Court of Appeals in Finance Co. of Pennsylvania *v.* Charleston C. & C. R. R. Co., 62 Fed. Rep. 205. SIMONTON, Circuit Judge, said: "The provisions of section 1255 manifestly recognize that equity which, in the decisions of the Supreme Court, underlies Fosdick *v.* Schall, 99 U. S. 235, and the cases following it. Whoever contributes to keep a corporation a going concern by materials or labor must be provided for before mortgage creditors can claim out of the earnings; and so, also, all expenses incident to the keeping it a going concern, including in the expenses all damages for injuries done to life, per-

§ 559. Debts contracted for construction.— A debt contracted for "construction" is not entitled to a priority of payment, in proceedings for the foreclosure of a mortgage of the property of a railroad corporation, which is recognized in Fosdick *v.* Schall, 99 U. S. 235, as the equitable right in some cases of a creditor for "operating expenses."[1] The United States Circuit Court of Appeals for the fifth circuit held that, upon the sale of this railroad on foreclosure, it was error to direct payment of claims for supplies furnished prior to the receivership out of the purchase money, no provision for such payment having been made when the receiver was appointed, and there being no evidence that current earnings, before or after the appointment of the receiver, were diverted to the payment of interest on the bonded debt.[2]

§ 560. Presumption as to preferential character of a claim — In this action for foreclosure of a railroad mortgage, the Circuit Court allowed an intervening claim based on a judgment recovered in a state court, and directed its payment out of the proceeds of sale. The decree in the case recited that it was one of those claims theretofore adjudged to be of a preferential character. This adjudication as to its preferential character was not appealed from, and the appeal from the decree allowing its payment, the nature of the demand on which the judgment was recovered, was not disclosed by the record. The United States Court of Appeals for the eighth circuit held that it must be presumed that the finding of the lower court as to the character of the claim was correct, and then affirmed the decree allowing it.[1]

son or property in keeping up this life of the company, enjoying the same preference." Frazier *v.* East Tenn., Va. & Ga. R. R. Co., 88 Tenn. 138; s. c., 12 S. W. Rep. 537.

[1] Mr. Justice LAMAR in Wood *v.* Guarantee Trust & Safe Deposit Co., (1888) 128 U. S. 416; s. c., 9 Sup. Ct. Rep. 131.

[2] Cutting *v.* Tavares O. & A. R. Co., (Florida Central & P. R. Co., Interveners), (1894) 61 Fed. Rep. 150. In American Loan & Trust Co. *v.* East & West R. R Co. of Ala., (Jersey City Iron Co., Intervener), (1891) 46 Fed. Rep. 101, it was held that a debt created for materials for original construction of a portion of a railroad more than six months before the appointment of a receiver in proceedings for the foreclosure of a mortgage was not within the rule authorizing the court to provide for arrears due for operating expenses of the road out of the net income of the property, and, in the absence of a showing that there had been such a diversion of current funds or income which should have been applied to the payment of the claim for such materials, would not be given a priority over the rights of the mortgage creditors.

§ 561. Mechanic's lien as viewed by the United States Supreme Court.—The trust company which had accepted the trust created in this railroad mortgage and certified the bonds issued under the mortgage, which were sold on the market, upon a default, brought action to foreclose the mortgage. There being a conflict between the interests of the bondholders under this mortgage and the bondholders under another affecting some of the properties, a committee of the bondholders were made parties co-complainants with the trust company. A question was made by an intervener as to whether his claimed mechanic's lien was not a lien prior and preferable to that of the mortgage. Subsequently to the execution of the mortgage he had contracted with the railroad company to build a dock on a river in one of the termini of the roads, a city in Ohio. He had built the dock, received only partial payment, and filed his mechanic's lien for the balance. The lot in which the dock was built was a part of the railroad property covered by this mortgage. The Supreme Court of the United States reversed the Circuit Court's decree in favor of the holder of the mechanic's lien giving him a priority, holding that a recorded mortgage, given by a railroad company on its roadbed and other property, created a lien the priority of which could not be displaced thereafter either directly by a mortgage given by the company or indirectly by a contract between the company and a third party for the erection of buildings or other works of original construction.[2] The master who reported upon the intervening petition of the holder of the mechanic's lien based his award of priority in this case upon the ground of an equitable right arising from the construction of the dock and consequent improvement of the railroad property. The Supreme Court of the United States held that those facts did not give the intervener an equitable lien prior in right to the lien of the mortgage, or furnish equitable reasons why the legal priority belonging to the mortgage should be displaced.[3] It was urged in behalf of the holder of the mechanic's lien in this case upon the

[1] St. Louis S. W. Ry. Co. *v.* Graham, Intervener, (1893) 56 Fed. Rep. 258, following Railway Co. *v.* Stark, 55 Fed. Rep. 758.

[2] Toledo, Delphos & Burlington R. R. Co. *v.* Hamilton. (1890) 134 U. S. 296.

[3] Ibid.

railroad property, in objection to the force of the propositions of law adverse to his claim of right of priority over the mortgage, as applied to the facts here, that at the time this mechanic's lien was created the legal title was not in the railroad company, but in a third party; that as the mortgagor, the railroad company, had no legal title the mortgage given by it created no legal lien; that while by the decree of foreclosure the legal title was transferred to the mortgagor, it was transferred subject to the burden of the mechanic's lien. The Supreme Court did not regard this contention of the appellee, as it appeared from the testimony and the decree that only the naked or legal title remained in this third party, the full equitable title being in the railroad company, and in that company before the contracts were entered into. They said: "The railroad company had the same title when it made the contracts that it had when the work was done and the decree rendered. Hamilton's contracts were with the railroad company, and of course gave a lien upon the lands only to the extent of the title that the railroad company had."[1]

[1] Toledo, Delphos & Burlington R. R. Co. *v.* Hamilton, (1890) 134 U. S. 296. The court distinguished, as showing a different state of facts from that in the case at bar, Williamson, Trustee, *v.* New Jersey Southern Railroad, 28 N. J. Eq. 277, and 29 N. J. Eq. 311, one of the cases especially relied upon to sustain the contention stated in the text, thus: "In [that case] the defendant railroad company had executed a mortgage with the 'after-acquired property' clause in it, duly recorded. It was also the owner of a large majority of the stock in the Long Branch and Sea Shore Company, and was in possession of and operating the latter company's road. No consolidation in fact of the two companies had taken place, but, being in possession of the latter company's road, it had contracted for the building of certain docks, walls and piers at the terminus of such road. Having failed to make payment for such work, a mechanic's lien was perfected upon the latter company's road. Upon a suit to foreclose the mortgage given by the defendant railroad company, the chancellor, laying hold of the fact that the defendant railroad company was the owner of the large majority of the stock — was in possession of and operating the latter company's road — decreed that such road, with its property and franchises, belonged to the defendant railroad company, and as after-acquired property was subject to complainant's mortgage, but subordinate to the mechanic's lien. On review in the Court of Errors and Appeals, as reported in 29 N. J. Eq. [311], the decision of the chancellor was sustained, the court saying: 'Until that decree was signed, the right of the complainant in the lands of the Sea Shore Company under his mortgage was a mere unexecuted equity to have the benefit of such equities as his mortgagor had in the premises, without any legal title in himself or in his mortgagor upon which his mortgage, as a consequence, could operate. * * * When the decree of the chancellor was signed, which established the lien of complainant's mortgage on the property of the Long Branch and Sea Shore Company, Berthoud & Co. had, by force of the provisions of the Mechanics' Lien Act, acquired a lien on the premises which related back to the commencement of the building, and was entitled to priority over all conveyances, mortgages or incumbrances subsequent thereto. This lien was not displaced by the chancellor's decree, which, in the absence of fraud, could be effective only to bring under the complainant's mortgage the lands of the Sea Shore Company, subject to such liens as were lawfully acquired while the legal estate was in that company. The chancellor's decree adjudging the validity and priority of the claim of Berthoud & Co. should be affirmed.' Unquestionably such ruling was correct. The owner of a majority of the stock in a railroad corporation has no title to the road. The title is in the corporation, and he is not the corporation. A mortgage by the owner of such stock is no lien upon the road, and does not prevent the casting of any legal lien upon it. So that while, for the many equitable reasons stated in the opinion, the decree vested the property in the latter road in the defendant railroad company, yet it perfected and transferred that title subject to all legal liens then existing upon it. As the Court of Errors and Appeals well said, until that decree was signed the right of the complainant, the mortgagee, was a mere unexecuted equity to have the benefit of such equities as his mortgagor had in the premises." A Connecticut case, Botsford *v.* New Haven, Middletown, etc., R. R. Co., 41 Conn. 454, also relied upon, was similarly distinguished by the Supreme Court as to the facts in these words: "After giving the mortgage the railroad company desired to erect a depot on land adjoining its track. The owner agreed to give the company the land provided it would build a depot. Upon the building a mechanic's lien was filed. The owner had never made a conveyance. Upon a foreclosure of the mortgage the mechanic's lien upon the building and the ground upon which it was constructed was held prior to the mortgage. The decision was based upon the ground that the full equitable title never passed to the railroad company until the completion of the building, and then passed subject to the burden of the mechanic's lien. Hence, though after-acquired property, and subject to the lien of the mortgage, it was, when acquired, already burdened with a lien."

§ 562. Furnishers of supplies — Kentucky statutes construed. — In this intervention in a foreclosure suit it was held that one who furnished labor and materials for the construction of this railroad, under a contract with a sub-contractor, was not embraced within the provision of the Kentucky statute, that persons furnishing labor or materials for the construction of railroads and other improvements "by contract, express or implied, with the owner or owners thereof, or by sub-contract thereunder, shall have a lien thereon" for the price of such labor and materials.[1] It was also held in the same case that the language, "all

[1] Central Trust Co. *v.* Richmond, N. I. & B. R. Co,. (1892) 54 Fed. Rep.

persons who perform labor or furnish labor," did not intend only those only who performed manual labor; and the words would embrace the services of a civil engineer who actually superin-

723. It was said by the court: "The decisions in the different states are in seeming conflict [upon this point], and it is unnecessary to review all of them, as each state has its own peculiar law and state policy. In some of the states it seems to be the policy to create the lien without regard to any contractual relation with the owner of the building or structure, and in other states to confine the lien to those who have contractual relations, directly or indirectly, with the owners of the building or structure, and, in some others, to combine the two by having regard to the contractual relations of the parties, by limiting the persons who, beside the owners, can create a contractual relation under which a lien can be created under the statute. The late Railroad Law of Wisconsin, and also that of Indiana, seems to be of the first class mentioned above. See Mundt *v.* Railroad Co., 31 Wis. 454; also, Redmond *v.* Railway Co., 39 Wis. 426; Colter *v.* Frese, 45 Ind. 97. The laws of other states are to the same effect. The statute of New Hampshire, as construed by the courts of that state, seems to be of the second class. See Jacobs *v.* Knapp, 50 N. H. 71. The [Kentucky] act of 1888, as we construe it, is of the third class, as are also the lien laws of Pennsylvania, West Virginia, Illinois, and the Mechanic Law of Wisconsin. In Harlan *v.* Rand, 27 Pa. St. 514, the court, after stating the great inconvenience of an indefinite extension of the liens under the construction of the statute contended for by counsel, asked, 'What, then, is the limit of these lien rights?' and said: 'We must look to the law for an answer, and we find it in the twelfth section. It distributes all the parties into three classes, according to their several functions: *First*, the owner; *second*, the contractor — called, also, architect and 'builder;' and, *third*, the workmen and materialmen. The law establishes one link, and only one link, between the owner, on the one hand, and the workmen and materialmen on the other. It requires the lien to be founded on contract, and it recognizes no one as having power to contract so as to make a lien against the building, except the owner and the contractor or architect.' Page 576. The West Virginia statutes provide that any mechanic, etc., who performs work or furnishes materials 'by virtue of any contract with the owner thereof, or his agents, or any person who, in pursuance of an agreement with any such contractor, shall, in conformity with the terms of the contract with such owners or agents, do or perform any labor or work, or furnish any material, in the erection or construction of a house,' etc., shall have a lien thereon. In McGugin *v.* Railway Co., 33 W. Va. 67; s. c., 10 S. E. Rep. 36, the court held a contractor once removed from the original contractor, had no lien under this statute. In Illinois the Lien Law of 1869 provided that: 'Every sub-contractor, mechanic, workman, or other person who shall hereafter, in pursuance of the purposes of the original contract between the owner of any lot or piece of ground, or his agent, and the original contractor, perform any labor or furnish materials in building, altering, repairing, beautifying or ornamenting any house, * * * shall have a lien for the value of such labor and materials upon such house,' etc. The Illinois courts held that the statute did not extend and give a lien to a contractor with a sub-contractor. Smith Bridge Co. *v.* Louisville, N. A. & St. L. R. Co., 72 Ill. 506."

tended and directed the construction of the work.[1] By the interventions in this foreclosure suit, the question of the rights of furnishers of supplies to the railroad company under the statutes of Kentucky giving statutory liens to certain parties to be preferred to the bondholders, came before the United States Circuit Court of Appeals for the sixth circuit. This rule was declared by the court: Contractors supplying laborers and teams for the construction and repair of a railroad, being paid for the same by the day, and either party having the right to stop work at the end of any day, are not "laborers" or "employees" with the terms of the statute of 1876, which, among other things, gives a lien for work done and materials furnished in keeping the road a going concern, but must rely on the Contractors' Act of 1888, which gives a lien in favor of persons "furnishing labor or materials for the construction or improvement" of any railroad, canal or other public improvement.[2] In the same case this rule was also declared:

[1] Central Trust Co. *v.* Richmond, N. I. & B. R. Co., (1892) 54 Fed. Rep. 723.

[2] Tod *v.* Kentucky Union Ry. Co. (Rosser et al., Interveners), (1892) 52 Fed. Rep. 241, holding that the petition of the intervener was properly dismissed. JACKSON, Circuit Judge, speaking for the court, said: "In Vane *v.* Newcombe, 132 U. S. 220; s. c., 10 Sup. Ct. Rep. 60, the plaintiff, having contracted with the company to erect certain telegraph wires on the company's poles, and furnished the labor of himself and others in doing the work, claimed a priority lien, under a statute of Indiana, which gave a lien to employees of corporations. The Supreme Court said: 'It seems clear to us that Vane was a contractor with the company and not an employee, within the meaning of the statute. We think the distinction pointed out by the Circuit Court is a sound one, namely, that to be an employee, within the meaning of the statute, Vane must have been a servant, bound in some degree, at least, to the duties of a servant, and not, as he was, a mere contractor, bound only to produce or cause to be produced a certain result — a result of labor, to be sure — but free to dispose of his own time and personal efforts according to his pleasure, without responsibility to the other party.' The lien was accordingly denied, and, in Railroad *v.* Wilson, 138 U. S. 501; s. c., 11 Sup. Ct. Rep. 405, it was said that an employee implies continuity of service and excludes those employed for a special or single transaction. In construing the New Jersey statute, which gave laborers of corporations in case of an insolvency a lien upon corporate assets for the amount of wages due them, the Supreme Court of that state held that the right conferred was strictly personal, inhering alone in the person who actually performs the labor or service, and that he who furnishes the labor or services of others under a contract to do the whole business of a corporation, or a particular branch of it, was neither within the letter nor spirit of the act. It was further held

Where supplies, suitable either for the construction of the unfinished part of a railroad or the carrying on of the finished part, are furnished without any contract as to how they shall be used, the materialman has a lien under the act of 1876 for the part actually used in operating the railroad and another lien under the Contractors' Act of 1888 for the part actually used for construction and repairs; but where he had lost the lien under the latter act because of a failure to file his statement within sixty days, the burden of proof was on him to show what part of the supplies was actually used for the operation of the road.[1]

§ 563. The rule under Ohio statutes.— The United States Circuit Court of Appeals for the sixth circuit, in the opinion rendered by SWAN, D. J., has held that the right to a lien, under the Ohio statute, relating to liens against railroads, is restricted to claims for labor performed or materials furnished for the construction of the road, depot buildings and water tanks, and cannot be extended to a claim for furnishing an electric lighting plant to hotel premises, at the instance of a railroad company; also, that the General Lien Law of Ohio gave no right to a lien upon a railroad for materials used in and for its construction; nor were materials furnished for the construction of the electric lighting apparatus, railway and power house, within the provision of the General Lien Law of Ohio, giving a right to a lien for machinery and materials furnished for "erecting, repairing or removing a house * * * or other structure.[2]"

§ 564. Contractors — Tennessee statutes construed.— In a case involving the right to priority of liens of persons claiming as contractors in the construction of a railroad under the Tennessee statute over those of the mortgage bondholders, the United States Circuit Court of Appeals for the sixth circuit declared these rules: Under the Tennessee statute, relating to railroad contractors' liens, the contractor must deal directly with the company in

by said court that the wages, to be within the protection of the statute, must be due to a person in the employ of the corporation at the time when it became insolvent; that only those in the employ of the corporation at the time of its insolvency were within either the words or policy of the statute. Delaware, L. & W. R. Co. *v.* Oxford Iron Co., 33 N. J. Eq. 196."

[1] Tod *v.* Kentucky Union Ry. Co. (Rosser et al., Interveners), (1892) 52 Fed. Rep. 241.

[2] Industrial & Mining Guaranty Co. *v.* Electrical Supply Co., (1893) 58 Fed. Rep. 732.

order to secure a lien for his work and material. If a sub-contractor, he can have no lien unless he serves notice on the railroad company of the principal contractor's failure to pay him, and unless, at the time of such notice, the company shall owe money to the principal on the contract which the sub-contractor has helped to perform, and the lien is limited to the amount so due the principal contractor. The principal contractor for the construction of this road was a dominant stockholder in the railroad corporation, and the sub-contractors endeavored to fix their liens on the ground that the principal contractor was acting in this transaction as agent of the corporation. Upon the points raised by this suggestion the Court of Appeals declared that the fact that he who made this construction contract with the railroad company was its principal stockholder, and dominated and controlled its action, did not render him an agent of the railroad company, so as to make his individual sub-contracts in law the contracts of the company, where neither he nor the company held out to the sub-contractors the existence of any such agency, or, as between themselves, had any intention of establishing such agency. Further, while construction contracts, made by a dominating stockholder with a railroad company for his own benefit are looked upon with suspicion and have the condemnation of the courts when drawn in question by other stockholders, bondholders, or by the corporation itself, their legal existence cannot be questioned by third persons who are not injured by them, as in this case, by sub-contractors who dealt with the contractor in his individual character.[1] The dominant stockholder in this railroad corporation, who had made a construction contract with the company in his individual character, had failed to pay the sub-contractors who had done the work of construction. These sub-contractors, afterwards, in order to give them and materialmen a lien on the railroad under the Tennessee statute in relation to such liens, through their representatives, acting with the principal contractor, and by means of his control over the board of directors of the railroad company, obtained an acknowledgment on the minutes of the railroad company of an amount still due him, vastly in excess of what was really due him, and more than sufficient to cover all the claims of these sub-contractors. The principal contractor sued for the amount mentioned on the minutes

[1] Central Trust Co. of New York *v.* Bridges, (1893) 57 Fed. Rep. 753.

of the railroad company, and the company's attorney consented to a judgment for that amount. As to the priority rights of this judgment, the United States Circuit Court of Appeals for the sixth circuit held that the judgment was fraudulent as against persons injured thereby, and, as an evidence of its rightfulness as a claim, was of no force when the claim was contested by holders of prior mortgage bonds of the company in a foreclosure suit in a federal court.[1]

§ 565. Furnishers of supplies — Virginia statutes on this subject construed.— A holder of the bonds of a railroad company, a Virginia corporation, had recovered judgment on his bonds against the railroad company, and upon his execution being returned "*nulla bona*," instituted an action in equity in the United States Circuit Court for the eastern district of Virginia, setting forth the insolvency of the company, etc., and for the appointment of a receiver, to which the trust company, trustee named in the mortgage securing the bonds, was admitted as a party, and a sale in foreclosure was asked. There were interventions in this suit by a car trust company and others who had furnished supplies to the railroad company, and out of these interventions arose questions of priority of liens of the mortgage bondholders and the furnishers of cars and supplies. The Code of Virginia, section 2462, provides that a conditional sale of rolling stock to a railroad company where legal title is reserved to the vendor until the purchase money is paid shall be void as to creditors and *bona fide* purchasers of the vendee unless the contract is recorded as therein required, and "each locomotive and car * * * be plainly and permanently marked with the name of the vendor on both sides thereof, followed by the new owner." It was held that a lien for the purchase money of rolling stock reserved by contract under this section was in no wise inconsistent with the existence of a lien under the Code of Virginia, section 2485, which gives to all who furnish supplies necessary to the operation of a railway "a prior lien on the franchise, gross earnings and all the real and personal property" of the road upon condition that the claim be recorded as required by the section following it. The cars here were furnished to the railroad company under a contract styled a "lease," which provided for payment of the purchase money in monthly installments with the right in the vendor on default to take possession of the cars and sell, returning any surplus after payment of the outstanding notes to the vendee. The name of the vendor was put upon the cars as "owner," and the contract was recorded as required in the case of conditional sales. The court held that the cars were "furnished" within the meaning of the Virginia statute declaring a supply lien in such cases, and nothing done by the vendor amounted to a waiver of such lien. As to the bondholders secured by the mortgage on all the property of the road before the cars were furnished, the sellers of the cars were held to be entitled to a prior lien on the property of the railroad company whether their contracts of claims of liens were properly recorded or not, as the mortgage only attached to the cars as after-acquired property, and was, therefore, subject to all existing equities whether there was notice to the mortgagors or not. There was a provision in the statute of Virginia as to the liens of those furnishing supplies to railroad companies that "unless [the furnisher] shall within six months after his claim has fallen due" file in a specified office a prescribed memorandum of his claim to be recorded. The time of furnishing the supplies was held to be immaterial so far as concerned the claim, and where the supplies were to be paid for in installments the claim must be filed and recorded within six months after the last installment falls due. Before some of these cars were furnished an act had been passed in Virginia giving a supply lien, which was held unconstitutional, as its title did not cover the object of the act. Afterwards the laws of the state were codified, including that act, and the act adopting the Code was passed before these cars were furnished, but it did not go into effect until a time later. As to these particular cars there was held to be no lien prior to the bondholders' lien, there being no valid act in existence creating such a lien when they were furnished. It was also held that a creditor's bill being filed against the railroad company, and the court referring the case to a commissioner to determine the claims and their priorities, the effect was to suspend the running of the six months within which the claim of lien was required to be filed by the Code of Virginia, section 2486.[1] Medical services rendered and

[1] Ibid.

[1] Newgass *v.* Atlantic & D. Ry. Co. (Central Car Trust Co. et al., Interveners), (1893) 56 Fed. Rep. 676. On this last point the court followed Seventh

board furnished by a hospital to an employee of the railroad company injured and disabled in its service were held not to be "supplies necessary for the operation of a railroad" within the statute giving a lien for supplies.[1]

§ 566. Loans of money to corporations before receivership.— The mere fact that money loaned to a railroad company was expended in payment of interest on its first mortgage bonds, or operating expenses, does not entitle the lender to preference over the first mortgage bonds by way of subrogation, or on the ground of superior equities. Although advances may have enabled a railroad company to maintain itself as a going concern, that fact alone does not give such advances priority over first mortgage bonds upon the theory that the interest of the public and of the bondholders were subserved by such advances.[2] In this Virginia

National Bank *v.* Shenandoah Iron Co., 35 Fed. Rep. 436.

[1] Newgass *v.* Atlantic & D. Ry. Co. (Central Car Trust Co. et al., Interveners), (1893) 56 Fed. Rep. 676.

[2] Morgan's La. & Tex. R. R. & Steamship Co. *v.* Texas Central Ry. Co., (1890) 137 U. S. 171. "From the account stated," said Chief Justice FULLER, speaking for the court, "it appears that the gross earnings were each year sufficient to pay the operating expenses and taxes, and that the deficit of each year was produced by the payment of interest on the bonded debt. But if the advances could, therefore, be treated as having been specifically procured for or specifically applied to the payment of interest as such (although there is no evidence to that effect), still such payments must afford no basis for the assertion of a preference as against the bondholders. So far as disclosed, the interest coupons were paid, not purchased (Ketchum *v.* Duncan, 96 U. S. 659; Wood *v.* Guarantee Trust Co., 128 U. S. 416), and cannot be set up as outstanding, and the contention is wholly inadmissible that the bondholders, because they received what was due them, should be held to have assented to the running of the road at the risk of returning the money thus paid, if the company, by reason of unrealized expectations on the part of those who made the advances, should ultimately turn out to be insolvent and unable to go on. By the payment of interest the interposition of the bondholders was averted. They could not take possession of the property, and should not be charged with the responsibility of its operation. It is true that a railroad company is a corporation operating a public highway, but it does not follow that the discharge of its public [duties?] excuses it from amenability for its private obligations. If it cannot keep up and maintain its road in a suitable condition and perform its public service for which it was endowed with its faculties and franchises, it must give way to those who can. Its bonds cannot be confiscated because it lacks self-sustaining ability. To allow another corporation, which, for its own purposes, has kept a railroad in operation in the hands of the original company, by enabling it to prevent those who would otherwise be entitled to take it from doing so, a

case bankers held coupons of early mortgage bonds, and had furnished the railroad company money which was used to pay wages and other preferred debts and received its promissory notes. Bonds were afterwards issued, secured on the income of the railroad company, and guaranteed by another company, to fund this indebtedness which was outstanding. These bankers took at sixty per cent the amount of their debt in these income bonds, received prior mortgage bonds as collateral, and surrendered the coupons, which were canceled, but there was no express agreement that their original claims were extingushed. The bankers claimed that they were entitled to a preference over the mortgage bondholders out of the funds to be distributed, upon the ground that as to the coupons there was a mere exchange of securities without affecting the debt of which the coupons were the evidence, and that, as to the promissory notes, the money for which they were given was used in the payment of preferred debts, and, therefore, they were entitled to be subrogated to the rights and privileges of the creditors whose debts were thus paid. Upon the well-settled principle that no mere change in the form of the evidence of a secured debt will discharge the debt, unless so intended, but that where a security is accepted in satisfaction of another the debt is discharged, and this would in general be determined by the surrender or retention of the original security, the Supreme Court of Appeals of Virginia held that these bankers were not subrogated to the lien of their original debt, which was extinguished by the receipt of the promissory notes.[1]

preference in reimbursement over the latter on the ground of superiority of equity would be to permit the speculative action of third parties to defeat contract obligations and to concede a power over the property of others which even governmental sovereignty cannot exercise without limitation. And, if all these advances should be considered as applied in payment of the operating expenses only, on the theory, where such was not literally the fact, that they supplied a deficit created by the payment of interest out of the gross earnings, the same remarks would be applicable." Where loans of money to carry on the business of a railroad corporation will be held to have a priority over the claims of the mortgage bondholders, see Farmers' Loan & Trust Co. *v.* Vicksburg & Meridian R. Co., 33 Fed. Rep. 778.

[1] Fidelity Insurance Trust & Safe Deposit Co. *v.* Shenandoah Valley R. R. Co., (1889) 86 Va. 1. As to the coupons being extinguished, after referring to the statement made by the officers of the company when they made it for the purpose of "listing" the bonded indebtedness of the company not showing any claim to the contrary, one of these claimants then being the president of the company and the other a director, the court

§ 567. Claims for services rendered the corporation prior to the appointment of a receiver.— There was in this case an order appointing the receiver which authorized him to pay out of income, besides current expenses and charges, all wages due to

said: "Upon the strength of these representations, sales of the bonds were no doubt effected to innocent purchasers, and it would now be the grossest injustice to such persons to allow the claims in question as a preferred charge on the mortgaged property, and thereby, to that extent, to impair the security of the mortgages. Plainly upon no just principle can this be done. A decisive authority upon this point is Addison *v.* Lewis, 75 Va. 701. There the president of the railroad company intervened and asserted a claim for several years' salary which accrued before the road went into the hands of a receiver, but as it appeared that in his published annual reports as president for the years in question, his salary for those years was put among the *paid items*, it was held that any right which he might have had to be paid in preference to the bondholders had been waived, although the salary in point of fact had not been paid. This ruling, it seems to us, is eminently just and proper, and in accordance with public policy, inasmuch as the officers of a railroad company are, in a general sense, trustees, and must, therefore, act in the strictest good faith in putting forth statements to the public as to the condition of the affairs of the company upon which innocent third persons, in their dealings with the company, have a right to rely. The same considerations apply to the promissory notes in question. * * * It appears moreover, that when the notes for the loans were taken, the [claimants] received general mortgage bonds of the company as collateral security for their payment, which goes far to show, if it does not conclusively show, that the idea of a right to subrogation is altogether an afterthought. For why take general or second mortgage bonds as collateral if the understanding was that [claimants] were to stand in the place of those whose equities were superior even to the first mortgage? To this question the answer must be, that the money was loaned on the credit of the company and the collaterals so furnished, alone. At all events, such is the fair inference from the record, and there is no evidence to repel it. In Addison *v.* Lewis, 75 Va. 701, a similar claim was asserted on the part of a bank for money advanced by it before the appointment of a receiver, and which was used by the railroad company in paying current expenses. The claim, however, was rejected. The court said: 'The bank discounted the paper of the company solely upon the credit of the company and upon collaterals deposited by the company with the bank. The acceptance of these collaterals was in itself a recognition of the subordination of the claim of the bank to the lien of the bondholders, and is sufficient to estop the bank from setting up the claim preferred in the petition.' The case of Coe *v.* N. J. Midland Rwy. Co., 31 N. J. Eq. 105, and Atkins *v.* Petersburg R. R. Co., 3 Hughes, 307, relied on by the [claimants], are not in point, as in each of those cases the advances were made, at the instance of the debtor, on a distinct understanding, clearly established, that the parties by whom they were made, should be subrogated to the rights of the creditors whose

employees of the railroad company at the date of the order for services within ninety days theretofore. It was held by the United States Circuit Court for the district of South Carolina that a lawyer employed by the company at a fixed salary per month came within the terms of this order and gave him a priority to the bondholders to that extent. But upon his claim for salary for months prior to the ninety days and for money advanced by him in connection with rendering his services, they held that he was not entitled, on the appointment of the receiver in foreclosure proceedings, to receive payment out of the proceeds of the sale, prior to the satisfaction of the mortgage bonds, even though the earnings of the road had been improperly diverted from current expenses for the benefit of bondholders, or the equity to a return of diverted earnings applied only in favor of those who have helped to keep the road a going concern. He was allowed to take a judgment against the railroad company for so much of his claim as was not performed, and his right to retain papers in his hands for the whole claim was recognized.[1] The court also held that legal services rendered to the railroad company in maintaining before the courts the validity of municipal aid bonds, were not of a character to take precedence of the company's mortgage bonds, within the doctrine of Fosdick *v.* Schall, 99 U. S. 235, and equity had no authority to give them such precedence, especially where the services were rendered two years before the appointment of the receiver. Nor would the fact that such services resulted in benefit to the bondholders, justify displacing the lien of the bondholders when they were not parties to the contract of employment.[2] In this foreclosure suit, upon the intervention of one who had been the general passenger and freight agent of a navigation company which had a business connection with the railroad company involved here, the United States Circuit Court for the district of South Carolina held that the company having passed into the hands of a receiver, the intervener had a valid claim for the arrears of his salary as gen-

debts were paid with the money advanced." See 3 Pom. Eq. § 1212, and cases in the notes.

[1] Finance Co. of Pennsylvania *v.* Charleston, C. & C. Ry. Co. (Moon, Intervener), (1892) 52 Fed. Rep. 526. See as to first ruling, Railroad Co. *v.* Wilson, 138 U. S. 505; s. c., 11 Sup. Ct. Rep. 405.

[2] Finance Co. of Pennsylvania *v.* Charleston, C. & C. R. Co. (Shand et al., Interveners), (1892) 52 Fed. Rep.

eral freight and passenger agent, but had no equity, as he claimed, to be paid in priority to the mortgage creditors.[1]

§ 568. When cases are not properly removable to United States court from state court.— Where a case involving railroad bonds had been removed to the United States Circuit Court by order of a state court upon the ground of "prejudice or local influence," JACKSON, Circuit J., remanded the case to the state court. His holdings upon the questions involved were that when, in a suit by persons owning certain "equipment bonds" of a railroad company, the United States Supreme Court decides that such bonds constitute no lien on the property, and subsequently a State Supreme Court, in a suit on other bonds of the same issue, reaches an opposite conclusion, this latter decision cannot be considered as showing "prejudice or local influence," so as to constitute a ground for removing a third suit in a subordinate court of the state, on still other bonds of the series, to the Federal Circuit Court. As to the interest of removing defendants, it was held that in a suit to assert the lien of such railroad equipment bonds, the trustees under mortgages to secure subsequent issues of bonds had no interest in the controversy as parties defendant, such as would give them a right to remove the cause to a federal court, where their mortgages had all been foreclosed and the property sold to a new corporation. Under a valid decree of a court of competent jurisdiction as to citizenship of parties, it was held that where in a suit by a corporation in a state court against several railroad companies, their trustees and mortgagees, on certain equipment bonds, the lien whereof was denied by answer, many other holders of the same series of bonds were permitted, with plaintiff's consent, to become parties defendant, and by cross-bills to set up the lien of their bonds; that in determining whether the citizenship of the parties was such as to warrant a removal to the Federal Circuit Court on the ground of prejudice and local influence, all the parties asserting the lien of the bonds should be considered as parties plaintiff; and that when part of the plaintiffs, as thus arranged, were aliens, and others were residents of the same state with some of the remaining defendants, the federal court had no jurisdiction.[1]

678. See Hand *v.* Railroad Co., 21 S. C. 162; Bound *v.* Railway Co., 51 Fed. Rep. 60.

[1] Bound *v.* South Carolina Ry. Co. (Quintard, Intervener), (1892) 50 Fed Rep 312. The district judge, SIMONTON, called attention to the fact that the doctrine of Fosdick *v.* Schall, 99 U. S. 235, had never been applied in any case except that of a railroad, and cited Wood *v.* Guarantee Trust & Safe Deposit Co., 128 U. S. 421; s. c., 9 Sup. Ct. Rep. 131, involving water works bonds and coupons, in which the point was pointed out by the justice delivering the opinion, but the court did not find it necessary to decide it. SIMONTON, D. J., held that it did not apply, and very fully discusses the matter of the distinction between railroad corporations and other private corporations in this regard.

[1] Adelbert College of Western Reserve University *v.* Toledo, W. & W Ry. Co., (1891) 47 Fed. Rep. 836.

CHAPTER XXXI.

TAXATION BY PUBLIC CORPORATIONS.

§ 569. General rules.
570. Exemption from taxes.
571. License tax.
572. Assessment of taxes for benefits.
573. When a levy of taxes by a school district is not authorized.
574. Irregularity in the levy of taxes.
575. When an assessment cannot be attacked.
576. Federal taxation of incomes.
577. Injunction of a collection of taxes.

§ 569. General rules.— It is within the power of the legislature to authorize a city to impose a yearly tax upon corporations doing business within the limits of the city.[1] A city will be precluded from levying a license tax on an express company by the provision in a statute that express companies shall pay a privilege tax to the state, and that no company which has paid such tax shall be liable to pay any other tax in the state.[2] In determining whether the percentage of a tax levy is in excess of the limit prescribed by statute to the city, a yearly deposit in the taxes collected as regards the amount levied cannot be taken in account.[3] The making of a subsequent levy of taxes, which, together with the original levy, may exceed the limit of taxation imposed by law upon a city, will not render invalid the levy originally made, which was not in excess of the limit.[4] Though a municipal election had resulted in a majority of votes against the issue of bonds for school purposes mentioned in the statute, which provided for the raising of revenue for school purposes by a city of the state of Georgia, the Supreme Court of the state held that under the statutes the mayor and council might levy an annual tax for school purposes.[5] A public corporation authorized to tax professions, trades, incomes and franchises, has been held not to be bound to tax them uniformly as to amount.[6] The right to levy taxes is conferred upon a town by a provision in its charter to

[1] Harrisburg City *v.* Pennsylvania Telephone Co., 15 Pa. Co. Ct. Rep. 518.

[2] Douglass *v.* City of Anniston, (Ala.) 16 So. Rep. 133.

[3] Bassett *v.* City of El Paso, (Tex. Civ. App.) 28 S. W. Rep. 554.

[4] Bassett *v.* City of El Paso, (Tex.) 30 S. W. Rep. 893.

[5] Ayers *v.* McCalla, (Ga.) 22 S. E. Rep. 295.

[6] State *v.* Worth, (N. C.) 21 S. E. Rep. 204.

"pass such rules and ordinances as may be necessary * * * for the levying of taxes."[1] The statute of Missouri in regard to the levy of school taxes on railroads provides for the furnishing by the school board of an estimate of the amount of funds necessary to sustain the schools to the county clerk, "stating clearly the amount deemed necessary for each fund and the rate required to raise the amount." The Supreme Court of Missouri has held that the value of the property to be assessed having been ascertained, the failure in the report of the school board to specify the amount of each fund did not invalidate the tax, if the rate necessary to raise the same was stated, as the amounts might be calculated from the data given.[2] School directors are empowered by a statute of Illinois to levy taxes not exceeding two per cent for educational purposes and three per cent for building purposes. A tax for educational purposes of more than two per cent has been held by the Supreme Court of the state to be void as to the excess, even though the taxes levied for the two purposes did not exceed five per cent.[3] That a school district has illegally levied and collected taxes on lands in another school district will not prevent the latter from levying and collecting taxes on the same lands.[4] The trustees of a school district having repaired a lawfully condemned school house out of their own private funds, property owners cannot avoid a tax afterwards lawfully imposed to pay for the repairs.[5] A special assessment on the property of a school district to raise the money will be authorized by a vote of the electors of the district to appropriate moneys for school purposes, and to issue bonds for raising it.[6] Failure to prefix to their tax list a heading "showing for what purpose the different items of a tax is levied," required by the statute of New York, by the trustees of a school district, has been held not to vitiate the assessment of taxes made by them, the provision being directory only.[7] The object of a meeting of the voters

[1] State *v.* Hoff, (Tex. Civ. App.) 29 S. W. Rep. 672.

[2] St. Louis & Santa Fe Ry. Co. *v.* Gracy, (Mo.) 28 S. W. Rep. 736.

[3] Chicago & A. R. R. Co. *v.* People, 155 Ill. 276; s. c., 40 N. E. Rep. 602.

[4] Arthur *v.* School District of Polk Borough, 164 Pa. St. 410; s. c., 30 Atl. Rep. 299; 35 W. N. C. 289.

[5] Louisville & Nashville R. R. Co. *v.* Trustees School District No. 108 (Ky.) 29 S. W. Rep. 340.

[6] Chamberlain *v.* Board of Education of Cranbury Township in Middlesex County, (N. J.) 31 Atl. Rep. 1033 See, also, State *v.* City of Omaha, 39 Neb. 745.

[7] Thomson *v.* Harris, 34 N. Y. Supp. 885.

of a school district in Oregon was stated in the notice for the meeting to be "to levy a tax of 8½ mills for building a school house, and a tax of 1½ mills for the teachers' fund." A motion at the meeting that "we proceed to vote on the 10-mill tax" was held by the Supreme Court of Oregon sufficient to indicate that the tax referred to was that mentioned in the notice.[1] The statutes of Illinois require school directors to certify the amount of money required to be levied by special tax. A certificate of school directors that "we require the amount of two dollars on each one hundred dollars to be levied as a special tax for that purpose, and one dollar on each one hundred dollars for building purposes on the taxable property of our district for the year 1894" has been held, though irregular in form, not to be void.[2] A school district having power to levy an *ad valorem* tax or a poll tax, or both, should the trustees levy a tax on the property in the district for the repair of a condemned school house, the tax will not be rendered invalid by failure to levy a poll tax.[3]

§ 570. Exemption from taxes.— Where a municipality is authorized to tax *all* property it can exempt none, as delegated power to tax does not imply power to exempt from taxation.[4] It

[1] Vaughn *v.* School District No. 31 of Tillamook County, (Or.) 39 Pac. Rep. 393.

[2] Chicago & A. R. R. Co. *v.* People, 155 Ill. 276; s. c., 40 N. E. Rep. 602.

[3] Hunter *v.* Louisville & Nashville R. R. Co., (Ky.) 30 S. W. Rep. 645.

[4] Whiting *v.* Town of West Point, (1892) 88 Va. 905, awarding a writ of mandamus to compel the municipal authorities to assess the property of a corporation which, by ordinance, had been exempted from taxation. The court cited, in support of the text, Cooley on Taxation, 200; State *v.* Hannibal & St. J. R. Co., 75 Mo. 209; Austin *v.* Gas Company, 69 Tex. 180; Wilson *v.* Supervisors, 47 Cal. 91. It was then said: "These authorities, which are only a few of the many that might be cited to the same effect, show that the rule requiring all municipal powers to be construed strictly, applies especially to a case like the present. And the reason, as already suggested, is this: That the power of taxation, being an attribute of sovereignty, can be exercised only by the sovereign. Hence, when delegated by the legislature to a municipal corporation, the latter is considered, as *pro hac vice* the agent of the state, acting for the benefit of the municipality. In other words, the municipality, in the eye of the law, is the hand of the state by which the tax is laid and collected. Therefore, the statutory authority must be strictly pursued; for as an agency to sell does not imply an agency to buy, so neither does a delegated power to tax imply a power to exempt." That in taxation the municipality acts for the state, see Gilman *v.* City of Sheboygan, 2 Black, 510; Langhorne *v.* Robinson, 20 Gratt. 661; City of Richmond *v.* Richmond & D. R. R. Co., 21 Gratt. 604.

was attempted in this case to restrain a city of Pennsylvania from taxing the property of a corporation which published, bought and sold books for a profit, on the ground that it was a purely public charity. The Court of Common Pleas held that it could not have total exemption from taxation, on the ground that it sold at less than cost, or evenly gratuitously distributed some books.[1] The Supreme Court affirmed this decision, holding that a society organized as an institution of purely public charity, and as such exempted from taxation, may, as an aid to the accomplishment of its primary object, carry on business, or use part of its property for a business purpose, which will render such business or such part of its property taxable.[2] As to the exemption of church property from municipal corporation tax under the statutes of Pennsylvania, the Supreme Court of that state has held that under no circumstances is a church entitled to exemption from taxes on its property for more than the portion of the tax year during which it actually holds the title to the property; also, that under the statute of May 14, 1874 (P. L. 158), where church property is rented out and produces income or revenue, it is subject to taxation, although for a part of the time, certain days or hours of the week, the church also uses the rented portion for its own purposes.[3] They also declared the further rule that where a part of a building may be used solely for church purposes, and certain rooms in the building be rented for a school, the building may be divided for purposes of taxation, and the portion *used solely* for church purposes be declared exempt from taxation.[4] Under the Pennsylvania statutes a library building is subject to municipal taxation upon so much thereof as is rented and produces a revenue, although it might be otherwise exempt. Charging a price for the use of its books when they are taken out and

[1] American Sunday School Union *v.* Philadelphia, (1894) 14 Pa. Co. Ct. Rep. 213.

[2] American Sunday School Union *v.* City of Philadelphia, (1894) 161 Pa. St. 307. In Philadelphia *v.* Masonic Home of Penn., (1894) 160 Pa. St. 572, it was held that a home limited to indigent, afflicted and aged Free Masons, although supported by voluntary contributions, without charge to the beneficiaries and with no profit either to the corporation or its officers, was not a "purely public charity," exempt from taxation within the meaning of the Constitution and statutes of Pennsylvania.

[3] Philadelphia *v.* Barber, (1894) 160 Pa. St. 123; Sewickley Borough *v.* Sholes, 118 Pa. St. 165, distinguished.

[4] Philadelphia *v.* Barber, (1894) 160 Pa. St. 123.

annual dues from its members will not deprive the association of its exemption.[1] Where, by the opening of a city street, a part of the land used for a charitable institution, and not taxed, was cut off from the main lot, and it was put to no other use, it has been held that it was still exempt from taxation by the city.[2] The case stated in a Pennsylvania case, and agreed upon in an action by a county to secure taxes against a street railway company, declared "that the said lot and stables and the said horses, cars and vehicles are used only in and about the business of carrying passengers and produce, according to the defendant's corporate powers, and that they are appurtenant, necessary and indispensable therefor." The Supreme Court held the agreement above stated brought the case within the principle that the property of canal and railroad companies, and other *quasi* public corporations, necessary for the exercise of their several franchises as depots, houses and water stations, is not taxable for local purposes. The reason for this exemption is that these things enter into the very composition of the works of these corporations, and are essential to the exercise of their corporate functions, and for this reason are taxed by the state as included in the capital of corporations.[3] This court in another case declared that railroads, canals and gas companies must have the right of eminent domain in order to perform their functions. Their property, which is indispensable to their chartered rights, is represented by their capital stock, and

[1] Mercantile Library Company *v.* Philadelphia, (1894) 14 Pa. Co. Ct. Rep. 204; affirmed in Mercantile Library Co. *v.* City of Philadelphia and Taylor, Receiver of Taxes, (1894) 161 Pa. St. 155, upon the authority of Philadelphia *v.* Barber, (1894) 160 Pa. St. 123. See Donohugh *v.* Philadelphia Library Co., 86 Pa. St. 306; Young Men's Christian Association *v.* Donohugh, 7 W. N. C. 208.

[2] Ladies' United Aid Society, etc. (Methodist Home), *v.* Philadelphia, (1894) 14 Pa. Co. Ct. Rep. 215. The cases upholding assessments upon such property for improvements were distinguished. Wilkinsburg Borough *v.* Home for Aged Women, 131 Pa. St. 109; Philadelphia *v.* Pennsylvania Hospital, 134 Pa. St. 171, and 143 Pa. St. 368. The court said: "This is upon the ground that a claim of that kind, although called a tax, is in reality an assessment for benefits done to the property. It proceeds upon the theory that the property is made more valuable by the improvement of the street in front of it. It is charged once for all time."

[3] Northampton County *v.* Easton Passenger Railway Co., (1892) 148 Pa. St. 282; citing Westchester Gas Company *v.* County of Chester, 30 Pa. St. 232; County of Erie *v.* Western Transportation Co., 87 Pa. St. 434; Coatesville Gas Co. *v.* County of Chester, 97 Pa. St. 476.

as such is taxed specially by the legislature, and the law will not subject it to duplicate taxation by mere inference.[1]

§ 571. License tax.—The United States Supreme Court held that an ordinance requiring agents soliciting orders on behalf of manufacturers of goods to take out a license and pay a tax therefor, made by a municipal corporation under authority conferred by a statute of the state granting to such corporations power to levy and collect license taxes on hawkers, peddlers and merchants of all kinds, was an exercise, not of the police power, but of the taxing power, and when it was enforced against an agent sent by a manufacturer of goods in another state to solicit orders for the products of his manufactory, it imposed a tax upon interstate commerce, in violation of the provisions of the Constitution of the United States.[2] A telegraph company, a New York corporation, which had accepted the provisions of the act of congress,[3] whereby it put its lines at the service of the United States for postal, military and other purposes, and gave precedence to its business, sought to restrain the officers of the city of Charleston, South Carolina, from the collection of a license of $500, imposed upon it by an ordinance of the city, made under power conferred by a state statute in the United States Circuit Court for that district. On appeal to the United States Supreme Court the latter court held that the imposition of the license fee being upon business done exclusively within the city, and not including any business done to or from points without the state and not including any business done for the government of the United States, its

[1] Schuylkill County *v.* Citizens' Gas Co., (1892) 148 Pa. St. 162, holding that the gas pipes of the incorporated company for the supply of natural gas to consumers were not assessable *eo nomine* for local taxation either as land or as a part of the company's capital stock. The court, however, held that a house upon the land of the gas company occupied by a tenant was not a necessary part of the company's works or equipment, and was, therefore, taxable. See, also, Allegheny Co. *v.* McKeesport Diamond Market, 123 Pa. St. 164.

[2] Brennan *v.* Titusville, (1894) 153 U. S. 289. The court cited and commented upon the following cases in support of its ruling: Brown *v.* Maryland, 12 Wheat. 419, 444; Welton *v.* Missouri, 91 U. S. 275, 278; Leloup *v.* Mobile, 127 U. S. 640. 645; Robbins *v.* Shelby Taxing District, 120 U. S. 489; Asher *v.* Texas, 128 U. S. 129; Stoutenburgh *v.* Hennick, 129 U. S. 141; Lyng *v.* Michigan, 135 U. S. 161, 166; McCall *v.* California, 136 U. S. 104, 111; Crutcher *v.* Kentucky, 141 U. S. 47, 61; Ficklen *v.* Shelby County, 145 U. S. 1.

[3] Approved July 24, 1866, chap. 230; 14 Stat. 221; New Rev. Stat. § 5263.

officers or agents, was an exercise of the police power, and was not an interference with interstate commerce.[1]

§ 572. **Assessment of taxes for benefits.**—It is within the discretion of municipal authorities for a local improvement to require the special benefits accruing from such improvement to be assessed upon the property specially benefited, or to impose the same by way of special taxation. When an ordinance is passed authorizing a local improvement, it has the effect of creating a taxing district. Such a taxing district comprises all the property contiguous to the improvement, subject to special taxation for making the improvement. Special assessments and special taxes imposed for local improvements, unlike general taxes, are based upon benefits to the property against and upon which they are assessed and levied, arising from its increased value in consequence of the improvement. They proceed upon the basis of benefits to the particular property, and are authorized only when the local improvement, either actually or presumptively, benefits the particular property in an amount equal to the burden imposed. The levy being upon the basis of benefits accruing to the specific property, it becomes a charge only upon and against it, and liability for the tax is confined to that particular property.[2] The proceedings in the matter of levying assessments for a public improvement, it was contended in an Illinois case, were unwarranted, for the reason, among others, that the supervisor and assessor of the town, who had acted for the town in the matter, were not corporate authorities, within the meaning of the Constitution of the state authorizing the legislature to vest the corporate authorities of cities, towns and villages with power to make local improvements by special assessment. The Supreme Court

[1] Postal Telegraph Cable Co. *v.* Charleston, (1894) 153 U. S. 692. Cases cited by the court as to taxation, and whether in violation or not of the interstate commerce provisions of the Constitution: Telegraph Co. *v.* Texas, 105 U. S. 460; Ratterman *v.* Western Union Telegraph Co., 127 U. S. 411; State Freight Tax, 15 Wall. 232; West. Union Tel. Co. *v.* Alabama, 132 U. S. 472; Pacific Express Co. *v.* Seibert, 142 U. S. 339.

[2] Lightner *v.* City of Peoria, (1894) 150 Ill. 80. See Davis *v.* Litchfield, 145 Ill. 313; Craw *v.* Village of Tolono, 96 Ill. 256; Bloomington *v.* Chicago & Alton R. R. Co., 134 Ill. 452; White *v.* People, 94 Ill. 607; Enos *v.* Springfield, 113 Ill. 65; McLean County *v.* City of Bloomington, 106 Ill. 209; English *v.* City of Danville, 150 Ill. 92; Dunham *v.* Village of Hyde Park, 75 Ill. 371; Fagan *v.* City of Chicago, 84 Ill. 231.

held that the supervisor and assessor were the corporate authorities of a town, and special assessments for local improvements made by them were made by the corporate authorities of the town within the meaning of the Constitution.[1] A statutory direction that an assessment for benefits shall be levied upon each *separate* lot or parcel of land, or upon the *several* lots or parcels of land, has been held in New Jersey not to authorize the assessors to levy distinct assessments upon the component parts of a tract of land which the owner had always treated as an entirety. And it appearing that the commissioners authorized to levy an assessment for the construction of a sewer upon an entire tract of land on which were buildings, had ignored the existence of the buildings and levied distinct assessments upon the parts of the tract, dividing it by lines which intersected the buildings, the court held the assessment illegal, as it could not infer that the benefit accruing to the entire tract was the aggregate of these distinct assessments.[2] The principle of frontage assessment is not necessarily wrong. If that mode properly distributes the benefits among the owners of property benefited, there can be no objection to its use.[3] And where an ordinance provides for an improvement complete in itself, it will not follow that the ordinance is to be deemed void, because the utility of the improvement might be enhanced by the addition of something more which has been omitted.[4] It is no valid objection to a special tax for grading or paving a street, that the city or village is not required to pay the cost of improving the street intersections.[5] This court has also held that municipal authorities in cities and villages organized under the general law of Illinois for the incorporation of such municipalities have no power to provide that the cost of sprinkling its streets shall be paid by special assessment; the sprinkling of streets not being a local improvement, within the meaning of the statute authorizing cities and villages to make

[1] Jones *v.* Town of Lake View, (1894) 151 Ill. 663; citing Hundley *v.* Lincoln Park Commissioners, 67 Ill. 559; People *v.* Gage, 83 Ill. 486; People *v.* Salomon, 51 Ill. 37; People *v.* Mayor, 51 Ill. 18.

[2] The State, Muller, Prosecutor, *v.* Mayor & Council of City of Bayonne, (1892) 55 N. J. L. 102.

[3] The State, Raymond, Prosecutor, *v.* Mayor & Council of Borough of Rutherford, (1892) 55 N. J. L. 441; Jersey City *v.* Howeth, 30 N. J. L. 521; State, Pudney, Prosecutor, *v.* Passaic, 37 N. J. L. 65.

[4] Vane *v.* City of Evanston, (1894) 150 Ill. 616.

[5] Holt *v.* City of East St. Louis, (1894) 150 Ill. 530; upon the authority of Walters *v.* Town of Lake, 129 Ill. 23.

local improvements by special assessment. They further held that the power of a city or village to provide for the sprinkling of streets by special assessment was not expressly given, nor did it arise, by implication, from the powers expressly conferred, nor was it essential to the declared objects and purposes of the corporation. And an attempt by the municipal authorities to declare a purely private work a local improvement, within the meaning of the statute, would be *ultra vires*. While the power of a city council to declare what shall be local improvements is necessarily implied from the power to make the same, this implication can exist only in respect of improvements which cities and villages are authorized to make by special assessment or special taxation.[1] Assessments by commissioners for benefits and street improvements, where they have been on the ground and examined the premises and made their report of estimates according to the principles prescribed in the charter of a municipality, will not be set aside upon conflicting evidence of the justice or sufficiency of such assessments.[2] But when the proceedings of a board of commissioners of assessment are irregular and not in conformity to the municipal charter, the landowner may have them reviewed by *certiorari*, notwithstanding the fact that the charter gives the landowner, who presents to the board of public works written objections to the award made to him, a right to bring suit and have a trial by jury.[3] But a city cannot, by accepting and adopting an improvement of a street, compel property owners to pay for it by special assessment or special taxation.[4]

[1] City of Chicago *v.* Blair, (1894) 149 Ill. 310.

[2] The State, Simmons, Prosecutor, *v.* City of Passaic, (1893) 55 N. J. L. 485; State, Pudney, *v.* Passaic, 37 N. J. L. 65; Hunt *v.* Rahway, 39 N. J. L. 646; Hunt *v.* Rahway, 40 N. J. L. 615; Butler *v.* Passaic, 44 N. J. L. 171; Jelliff *v.* Newark, 48 N. J. L. 101; Hegeman *v.* Passaic, 51 N. J. L. 109.

[3] State, Walls, Prosecutor, *v.* Mayor & Aldermen of Jersey City, (1893) 55 N. J. L. 511; State *v.* Cassidy, 38 N. J. L. 437.

[4] City of East St. Louis *v.* Albrecht, (1894) 150 Ill. 506. The court said: "In City of Carlyle *v.* County of Clinton, 140 Ill. 512, after citing [certain sections of the law authorizing local improvements], we said: 'From these sections of the statute it is apparent that when a city undertakes to make a public improvement, the cost of which they expect to raise by special assessment or special taxation, the first step to be taken is the passage of an ordinance. The ordinance lies at the foundation of the proceeding, and unless the ordinance is passed there is nothing upon which the proceeding can rest. Section 1 confers power to make local improvements by special assessment or special taxation, as the city authorities shall by ordinance prescribe. This language does not contemplate that the city council shall go on and make the improvement, and, after it is completed, levy and collect a special assessment or tax for such improvement. * * * These sections of the statute are plain, and all point in one direction, that the first step to be taken when a local improvement is to be made, and to be paid for by special assessment or special taxation, is the passage of an ordinance by the city council. Until an ordinance is passed as required by the statute, no work can be done or expense incurred which can become a charge on the property of the landowner.'"

§ 573. When a levy of taxes by a school district is not authorized.— In a case where the board of education of a school district, consisting of a president and six members, met and passed an order that $10,000 be raised by special taxation for the current year, which was signed by three persons designated as directors of schools, but who in fact were members of the board of education, the Illinois Supreme Court held that the certificate did not authorize the levy of any tax, and that the proceedings to levy, extend and collect such tax were null and void.[1]

§ 574. Irregularity in the levy of taxes.— The same court in a taxpayers' suit for injunction of the treasurer of a county against collection of certain taxes held that mere irregularities in the levying of taxes or the making of assessments would not avoid their collection; and where any part of a tax or an assessment is due, that part must be paid, or at least an offer be made to pay it, before suit would lie to enjoin the collection of what might be alleged to be illegal. In this particular they held that an injunction would not lie on account of the fact that provision was made for collecting a part of the assessment for the construction of a free gravel road before it was actually needed for the payment of bonds or interest to become due.[2]

[1] People ex rel. Woody, Collector, *v.* Smith, (1894) 149 Ill. 549. The court said: "We held in Weber *v.* Ohio & Mississippi Railway Co., 108 Ill. 451, that the certificate which the school directors are empowered to make by the school law is the only basis for the imposition of special taxes for school purposes, and said: 'In a sense such certificates are jurisdictional, and any tax extended for school purposes where no such certificate has been returned by the directors, as required by the statute, is without authority of law, and null and void.' See, also, Leachman *v.* Dougherty, 81 Ill. 324; Peoria, Decatur & Evansville Railway Co. *v.* Commissioners, 116 Ill. 232; Ohio & Mississippi Railway Co. *v.* Commissioners, 117 Ill. 280; Lawrence *v.* Traner, 136 Ill. 474."

[2] Florer, Treasurer, *v.* McAffee, (1893) 135 Ind. 540; citing City of Delphi *v.* Bowen, 61 Ind. 29; Foresman *v.* Chase, 68 Ind. 500; Mullikin *v.* Reeves, Treasurer, 71 Ind. 281; Stilz *v.* City of Indianapolis, 81 Ind. 582; Volger *v.* Sidener, 86 Ind. 545; Miles, Treasurer, *v.* Ray, 100 Ind.

§ 575. **When an assessment cannot be attacked.**— The action of a county board of equalization in Indiana has been held not subject to collateral attack by injunction or otherwise, unless the assessment be void, and not merely erroneous, and the Supreme Court reversed the court below, which had granted an injunction to the corporation complaining, restraining the collection of the taxes assessed against it.[1]

166; Bothwell *v.* Millikan, 104 Ind. 162. The court, in Florer, Treasurer, *v.* McAffee, *supra*, said: "The duplicate being put into the hands of the treasurer and being legal on its face, was sufficient to justify the treasurer in collecting the assessments, unless it be shown that some essential requirement of the law was not observed in its preparation or in the proceedings upon which its preparation was based. *Prima facie*, the duplicate is sufficient authority for the collection of the assessments. Noland *v.* Busby, 28 Ind. 154; Rutherford *v.* Davis, 95 Ind. 245; Adams *v.* Davis, 109 Ind. 10." In support of the second ruling it was said: "Those having charge of the collection of funds to meet the obligations of the county are required to use diligence, and they must also be allowed the exercise of good judgment in providing in time for the payment of such obligations so that the credit of the county may not be impaired. Rickets *v.* Spraker, 77 Ind. 371."

[1] Jones, Treasurer, *v.* Rushville Natural Gas Co., (1893) 135 Ind. 595. The court said: "This case is, we think, easily distinguished from the case of Hyland, Auditor, *v.* Brazil Block Coal Co., 128 Ind. 335. In that case it was a conceded fact that the capital stock was all invested in tangible property, which had been returned for taxation, and that the capital stock did not exceed in value the tangible property. The question, however, as to whether the action of the board of equalization could be attacked collaterally was not argued or decided, while that question in this case is squarely made. The board of equalization not only has the power to assess the capital stock of a corporation where the value of such stock exceeds the value of the tangible property, but it is its duty to do so. Rev. St. § 6358; Hyland, Auditor, *v.* Central Iron & Steel Co., 129 Ind. 68. The board, in such cases, has exclusive, original jurisdiction, and, while its action is not strictly judicial, it is at least *quasi* judicial, and binds every one within its jurisdiction. Wilkins *v.* State, 113 Ind. 514; Kuntz *v.* Sumption, Treas., 117 Ind. 1. It is true that such board cannot legally assess capital stock where the capital is invested in tangible property listed for taxation, unless such stock exceeds in value the property in which it is invested; but who shall determine the question as to whether the stock is of greater value than the tangible property? The board of equalization, we think, must decide that question. If it makes a mistake and reaches a wrong conclusion, can it be said that its assessment is void? We think not. We think it is binding on the corporation assessed until set aside or vacated by appeals or some other authorized direct proceeding. * * * We think it is settled, by abundant authority, that the action of the board of equalization, in a matter over which it has jurisdiction, binds every one interested in such matter." See Board *v.* Senn, 117 Ind. 410; Cooley on Taxation, 747, 748; Small, Rec., *v.* City of Lawrenceburgh, 128 Ind. 231.

§ 576. **Federal taxation of incomes.**— The United States Supreme Court, when the question of the constitutionality of the income tax imposed by the government upon the income of corporations and citizens, upon a bill filed by a stockholder of a trust company to prevent its voluntarily making returns for the imposition and payment of such tax, upheld the jurisdiction of a court of equity to grant the relief asked.[1] Upon the merits of the case made by this stockholder's bill to restrain a voluntary return by the corporation required by the Income Tax Act, the majority of the Supreme Court of the United States held that the income tax imposed by congress, so far as it proposed to levy a tax on the rents or income of real estate, was a direct tax within the meaning of the Constitution, and not being apportioned as required by that instrument was repugnant to the Constitution and invalid.[2] Upon the merits of the case made by this stockholder's bill, the United States Supreme Court, HARLAN and WHITE, JJ., dissenting, held that the income tax imposed by congress, so far as it levied a tax on the rents or income of real estate, was in violation of the Constitution of the United States, and invalid.[3] The Income Tax Act provided "that nothing

[1] Pollock *v.* Farmers' Loan & Trust Company, (1895) 157 U. S. 429. FULLER, Ch. J., rendering the opinion for the court, said: "The jurisdiction of a court of equity to prevent any threatened breach of trust in the misapplication or diversion of the funds of a corporation by illegal payments out of its capital or profits has been frequently sustained. Dodge *v.* Woolsey, 18 How. 331; Hawes *v.* Oakland, 104 U. S. 450. As in Dodge *v.* Woolsey, this bill proceeds on the ground that the defendants would be guilty of such breach of trust or duty in voluntarily making returns for the imposition of, and paying, an unconstitutional tax; and, also, on allegations of threatened multiplicity of suits and irreparable injury. The objection of adequate remedy at law was not raised below, nor is now raised by appellees, if it could be entertained at all at this stage of the proceedings; and, so far as it was within the power of the government to do so, the question of jurisdiction, for the purpose of the case, was explicitly waived on the agreement. The relief sought was in respect of voluntary action by the defendant company, and not in respect of the assessment and collection themselves. Under these circumstances, we should not be justified in declining to proceed to judgment upon the merits. Pelton *v.* National Bank, 101 U. S. 143, 148; Cummings *v.* National Bank, 101 U. S. 153, 157; Reynes *v.* Dumont, 130 U. S. 354."

[2] Pollock *v.* Farmers' Loan & Trust Co., (1895) 157 U. S. 429.

[3] Pollock *v.* Farmers' Loan & Trust Co., (1895) 157 U. S. 429. The case mainly relied upon to uphold the constitutionality of the Income Tax Act was Hylton *v.* United States, 3 Dall. 171. FULLER, Ch. J., reviewed

herein contained shall apply to states, counties or municipalities." It was contended before the United States Supreme Court on the part of the government that although the property or revenues of the states or their instrumentalities could not be taxed, nevertheless the income derived from state, county and municipal

the various other cases to which the court's attention was called in these words: "In Pacific Insurance Co. *v.* Soule, 7 Wall. 433, the validity of a tax which was described as 'upon the business of an insurance company' was sustained on the ground that it was 'a duty or excise,' and came within the decision in Hylton's case. The arguments for the insurance company were elaborate and took a wide range, but the decision rested on narrow ground, and turned on the distinction between an excise duty and a tax strictly so termed, regarding the former a charge for a privilege, or on the transaction of business, without any necessary reference to the amount of property belonging to those on whom the charge might fall, although it might be increased or diminished by the extent to which the privilege was exercised or the business done. This was in accordance with Society for Savings *v.* Coite, 6 Wall. 594; Provident Institution *v.* Massachusetts, 6 Wall. 611, and Hamilton Company *v.* Massachusetts, 6 Wall. 632, in which cases there was a difference of opinion on the question whether the tax under consideration was a tax on the property and not upon the franchise or privilege. And see Van Allen *v.* The Assessors, 3 Wall. 573; Home Insurance Co. *v.* New York, 134 U. S. 594; Pullman Company *v.* Pennsylvania, 141 U. S. 18. In Veazie Bank *v.* Fenno, 8 Wall. 533, 544, 546, a tax was laid on the circulation of state banks, or national banks paying out the notes of individuals or state banks, and it was held that it might well be classed under the head of duties and as falling within the same category as Soule's Case, 7 Wall. 433. It was declared to be of the same nature as excise taxation on freight receipts, bills of lading and passenger tickets issued by a railroad company. And referring to the discussion in the convention which framed the Constitution, Mr. Chief Justice CHASE observed that what was said there 'doubtless shows uncertainty as to the true meaning of the term direct tax; but it indicates also an understanding that direct taxes were such as may be levied by capitation, and on lands and appurtenances; or perhaps by valuation and assignment of personal property upon general lists. For these were the subjects from which the states at that time usually raised their principal supplies.' And in respect of the opinions in Hylton's case, the chief justice said: 'It may further be taken as established upon the testimony of Paterson, that the words direct taxes, as used in the Constitution, comprehended only capitation taxes and taxes on land, and perhaps taxes on personal property by general valuation and assessment of the various descriptions possessed within the several states.' In National Bank *v.* United States, 101 U. S. 1, involving the constitutionality of section 3413 of the Revised Statutes, enacting that 'every national banking association, state bank, or banker or association, shall pay a tax of ten per centum on the amount of notes of any town, city or municipal corporation, paid out by them,' Veazie Bank *v.* Fenno was cited with approval to the point that congress, having undertaken to provide a currency for the whole country, might, to secure the benefit of it to the people, restrain, by suitable enactments, the circulation as money of any notes not issued under its authority; and Mr. Chief Justice WAITE, speaking for the court, said: 'The tax thus laid is not on the obligation, but on its use in a particular way.' Scholey *v.* Rew, 23 Wall. 331, was a case of a succession tax which the court held to be plainly an excise tax or duty, upon the devolution of the estate or the right to become beneficially entitled to the same, or the income thereof, in possession or expectancy.' It was like the succession tax of a state held constitutional in Mager *v.* Grima, 8 How. 490; and the distinction between the power of a state and the power of the United States to regulate the succession of property was not referred to, and does not appear to have been in the mind of the court. The opinion stated that the act of parliament from which the particular provision under consideration was borrowed had received substantially the same construction, and cases under that act hold that a succession duty is not a tax upon income or upon property, but on the actual benefit derived by the individual determined as prescribed. In re Elwes, 3 H. & N. 719; Attorney-General *v.* Sefton, 2 H. & C. 362; s. c., (H. L.) 12 L. T. 242; 11 H. L. Cas. 257. In Railroad Company *v.* Collector, 100 U. S. 595, 596, the validity of a tax collected of a corporation upon the interest paid by it upon its bonds was held to be 'essentially an excise on the business of the class of corporations mentioned in the statute.' And Mr. Justice MILLER, in delivering the opinion, said: 'As the sum involved in this suit is small, and the law under which the tax in question was collected has long since been repealed, the case is of little consequence as regards any principle involved in it as a rule of future action.' All these cases are distinguishable from that in hand, and this brings us to consider that of Springer *v.* United States, 102 U. S. 586, 602, chiefly relied on and urged upon us as decisive. That was an action of ejectment brought on a tax deed issued to the United States on sale of defendant's real estate for income taxes. The defendant contended that the deed was void because the tax was a direct tax, not levied in accordance with the Constitution. Unless the tax were wholly invalid the defense failed. The statement of the case in the report shows that Springer returned a certain amount as his net income for the particular year, but does not give the details of what his income, gains and profits consisted in. The original record discloses that the balance was not derived in any degree from real estate, but was in part professional as attorney at law, and the rest interest on United States bonds. It would seem probable that the court did not feel called upon to advert to the distinction between the latter and the former source of income, as the validity of the tax as to either would sustain the action. The opinion thus concludes: 'Our conclusions are, that *direct taxes*, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate,

securities could be taxed. The majority of the court held that in so far as the Income Tax Act proposed to levy a tax upon the interest received by the holders of municipal bonds, as income, the act was repugnant also to the Constitution, and such tax

would be invalid.[1] Upon a rehearing of this case the United States Supreme Court, by a majority, adhered to their former rulings, and their conclusions are those summed up by Mr. Chief Justice FULLER: First. "We adhere to the opinion already announced, that taxes on real estate being indisputably direct taxes, taxes on the rents or income of real estate are equally direct taxes. Second. We are of opinion that taxes on personal property, or on the income of personal property, are likewise direct taxes. Third. The tax imposed by sections twenty-seven to thirty-seven, inclusive, of the act of 1894, so far as it falls on income of real estate and of personal property, being a direct tax within the meaning of the Constitution, and, therefore, unconstitutional and void because not apportioned according to repre-

[1] Pollock *v.* Farmers' Loan & Trust Co., (1895) 157 U. S. 429. Mr. Chief Justice FULLER, in delivering the opinion, said, upon the contention of the government: "We think the same want of power to tax the property or revenues of the states or their instrumentalities exists in relation to a tax on the income from their securities, and for the same reason, and that reason is given by Chief Justice MARSHALL in Weston *v.* Charleston, 2 Pet. 449, 468, where he said: 'The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. It may be carried to an extent which shall arrest them entirely. * * * The tax on government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently to be repugnant to the Constitution.' Applying this language to these municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the Constitution. Before this it had been said by the chief justice, *arguendo:* 'The Constitution contemplates the independent exercise by the nation and the state, and severally, of their constitutional powers. As the states cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the Constitution to tax either the instrumentalities or the property of a state. A municipal corporation is the representative of the state and one of the instrumentalities of the state government.' It was long ago determined that the property and revenues of municipal corporations are not subjects of federal taxation. Collector *v.* Day, 11 Wall. 113, 124; United States *v.* Railroad Company, 17 Wall. 322, 332. In Collector *v.* Day it was adjudged that congress had no power, even by an act taxing all incomes, to levy a tax upon the salaries of judicial officers of a state, for reasons similar to those on which it had been held in Dobbins *v.* Commissioners, 16 Pet. 435, that a state could not tax the salaries of officers of the United States. Mr. Justice NELSON, in delivering judgment, said: 'The general government and the states, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The power in its appropriate sphere is supreme; but the states within the limits of their powers, not granted; or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the states.' This is quoted in Van Brocklin *v.* Tennessee, 117 U. S. 151, 178, and the opinion continues: 'Applying the same principles, this court, in United States *v.* Railroad Company, 17 Wall. 322, held that a municipal corporation within a state could not be taxed by the United States on the dividends or interest of stock or bonds held by it in a railroad or canal company, because the municipal corporation was a representative of the state, created by the state to exercise a limited portion of its powers of government, and, therefore, its revenues, like those of the state itself, were not taxable by the United States. The revenues thus adjudged to be exempt from federal taxation were not themselves appropriated to any specific public use, nor derived from property held by the state or by the municipal corporation for any specific public use, but were part of the general income of that corporation, held for the public use in no other sense than all property and income, belonging to it in its municipal character, must be so held. The reasons for exempting all the property and income of a state, or of a municipal corporation, which is a political division of the state, from federal taxation, equally require the exemption of all the property and income of the national government from state taxation.' In Mercantile Bank *v.* New York, 121 U. S. 138, 162, this court said: 'Bonds issued by the state of New York, or under its authority by its public municipal bodies, are means of carrying on the work of the government, and are not taxable even by the United States, and it is not a part of the policy of the government which issues them to subject them to taxation for its own purposes.' The question in Bonaparte *v.* Tax Court, 104 U. S. 592, was whether the registered public debt of one state, exempt from taxation by that state, or actually taxed there, was taxable by another state when owned by a citizen of the latter, and it was held that there was no provision of the Constitution of the United States which prohibited such taxation. The states had not covenanted that this could not be done, whereas, under the fundamental law, as to the power to borrow money, neither the United States on the one hand, nor the states on the other, can interfere with that power, as possessed by each and an essential element of the sovereignty of each."

sentation, all those sections constituting one entire scheme of taxation, are necessarily invalid."[1]

§ 577. Injunction of a collection of taxes.— A railroad company, the property of which, by its acceptance of an act of the territorial legislature of North Dakota, was exempted until that act was repealed by the Constitution adopted when the territory became a state, it having paid the percentage of its gross earnings in lieu of the taxes for certain years as required by the act, sought in this case to restrain the officers of certain counties of the state from enforcing a tax upon its lands within those counties. The company having failed to make the payment for this particular year of the designated percentage of its gross earnings, or to make a tender of what was due under one or the other modes of taxation, the United States Supreme Court held that it was not entitled to relief in equity to enjoin the enforcement of a tax upon its property as upon the property of individuals in the counties in which the property was situated.[2]

[1] Pollock *v.* Farmers' Loan & Trust Co., (1895) 158 U. S. 601; Hyde v. Continental Trust Co., (1895) 158 U. S. 601.

[2] Northern Pacific R. R. Co. *v.* Clark, (1894) 153 U. S. 252. It was said by the court: "In State Railroad Tax Cases, 92 U. S. 575, 616, 617, the rule is established that before an injunction will be granted in such cases as the present, a party must pay or tender what can be seen to be due on the face of the bill; and speaking for the court in that case, Mr. Justice MILLER said that the duty of making such a tender or payment before any injunction will be allowed is laid down 'as a rule to govern the courts of the United States in their action in such cases.' This rule was repeated in National Bank *v.* Kimball, 103 U. S. 732, 733, where it was treated as a fatal objection to the bill that there was no offer to pay any sum as a tax which the party ought to pay; and, again, speaking for this court, Mr. Justice MILLER there said: 'We have announced more than once that it is the established rule of this court that no one can be permitted to go into a court of equity to enjoin the collection of a tax, until he has shown himself entitled to the aid of the court by paying so much of the tax assessed against him as it can be plainly seen he ought to pay,' etc."

CHAPTER XXXII.

TAXATION OF PRIVATE CORPORATIONS.

§ 578. General rules.
579. Exemption from taxation — rules.
580. Taxation of corporations — rules in New York.
581. Taxation of corporations — rules in Pennsylvania.
582. Privilege tax.
583. Computation of such — rule.
584. Taxation of banks and shares of bank stock — rules.
585. Taxation of railroad corporations — rules.
586. Taxation of insurance corporations.

§ 578. General rules.— Stock in a railroad company built for use in its mining business, owned by a coal mining company, the railroad company having been already taxed upon its value, has been held not to be subject to tax as the property of the coal mining company.[1] A corporation having been taxed on its capital stock, the stock in the hands of its several owners is not liable to be retaxed again.[2] The charter of a New Jersey corporation exempting its property from the imposition of any tax or assessment, the Supreme Court of that state held exempted the corporation not only from taxation generally, but also from assessments for benefits derived from public improvements.[3] The

[1] Commonwealth *v.* Fall Brook Coal Co., 156 Pa. St. 488; s. c., 26 Atl. Rep. 1071.

[2] Commonwealth *v.* Lehigh Coal & Navigation Co., (Pa.) 29 Atl. Rep. 664. What is an essential part of the corporate property of a corporation chartered for transporting and storing oil and petroleum, etc., and not taxable, see Mellon Pipe Lines *v.* Allegheny County, 3 Pa. Dist. Rep. 448. For the rule under the statutes of Pennsylvania as to the appraisal of the capital stock of a corporation for taxation, see Commonwealth *v.* Pittsburg & W. R. Co., 166 Pa. St. 453; s. c., 31 Atl. Rep. 202; 36 W. N. C. 137; Commonwealth *v.* Edgerton Coal Co., 164 Pa. St. 284; s. c., 30 Atl. Rep. 125; 35 W. N. C. 205. How net earnings for the purpose of taxation should be ascertained, see Commonwealth *v.* Philadelphia & E. R. R. Co., 164 Pa. St. 252; s. c., 30 Atl. Rep. 145; 35 W. N. C. 217. For rule in ascertaining the net income of a corporation for taxation under Pennsylvania statutes, see Commonwealth *v.* Minersville Water Co., 2 Pa. Dist. Rep. 738. When stock of a corporation is "issued and outstanding" for the purpose of taxation under New Jersey statutes, see American Pig-Iron Storage Co. *v.* State Board of Assessors, (N. J.) 29 Atl. Rep. 160. When franchise of corporation is not taxable under New Jersey statutes, see Passaic Water Co. *v.* City of Paterson, (N. J.) 29 Atl. Rep. 185.

[3] Hudson County Catholic Protectory *v.* Board of Township Committee of Kearney, (N. J.) 28 Atl. Rep. 1043, following Protestant Foster Home

Nebraska Supreme Court has held that the constitutional provision in that state exempting property of religious corporations from general taxation did not exempt it from special assessments for local improvements.[1]

§ 579. Exemption from taxation — rules.— The power to exempt railroad corporations from taxation is within the scope of legislative power.[2] The grant of immunity to a railroad corporation from taxation, to be recognized, must be so plain as not to be mistaken.[3] The legislature of Tennessee, in the exercise of its power, in the act incorporating this railroad company, in the year 1848, provided for an exemption from taxation of the company in these words: "That the capital stock of said company shall be forever exempt from taxation, and the road, with all its fixtures and appurtenances, including workshops, warehouses and vehicles of transportation, shall be exempt from taxation for the period of twenty-five years from the completion of the road, and no tax shall ever be laid on said road or its fixtures which will reduce the dividends below eight per cent." The state, as well as several counties, after the expiration of the twenty-five years, assessed the road and fixtures of the company for taxation, and the State Supreme Court allowed these taxes which were declared liens upon the property of the company. The United

Soc. *v.* Mayor, etc., of Newark, 36 N. J. Law, 478.

[1] City of Beatrice *v.* Brethren Church, (Neb.) 59 N. W. Rep. 932. Rules relating to the exemption of property of manufacturing corporations under statutes or ordinances of municipal corporations for their encouragement, see Commonwealth *v.* Keystone Bridge Co., 156 Pa. St. 500; s. c., 27 Atl. Rep. 1: Commonwealth *v.* Pittsburgh Bridge Co., 156 Pa. St. 507; s. c., 27 Atl. Rep. 4; Commonwealth *v.* Thackara Mfg. Co., 156 Pa. St. 510; s. c., 27 Atl. Rep. 13; Commonwealth *v.* J. B. Lippincott Co., 156 Pa. St. 513; s. c., 27 Atl. Rep. 10, following Commonwealth *v.* Wm. Mann Co., 150 Pa. St. 64; s. c., 24 Atl. Rep. 601; Commonwealth *v.* Juniata Coke Co., 157 Pa. St. 507; s. c., 27 Atl. Rep. 373; Commonwealth *v.* Savage Fire Brick Co., 157 Pa. St. 512; s. c., 27 Atl. Rep. 374; 33 W. N. C. 136; Commonwealth *v.* Pottsville Iron & Steel Co., 157 Pa. St. 500; s. c., 27 Atl. Rep. 371; 33 W. N. C. 112; Commonwealth *v.* East Bangor Consolidated Slate Co., (Pa.) 29 Atl. Rep. 706; s. c., 34 W. N. C. 534. For a construction of the constitutional provision of Louisiana exempting property employed in manufacturing, see State *v.* Board of Assessors, (La.) 15 So. Rep. 384; Electric Traction & Mfg. Co. *v.* City of New Orleans, (La.) 14 So. Rep. 231.

[2] Neary *v.* Phil., Wil. & Balt. R. R. Co., (Del.) 9 Atl. Rep. 405.

[3] Chicago, B. & K. C. R. R. Co. *v.* Guffey, 122 U. S. 561; s. c., 7 Sup. Ct. Rep. 1300.

States Supreme Court held that it clearly had jurisdiction to review the decision of the State Supreme Court, in view of the fact that the exemption was within the constitutional power of the legislature to grant to the company, and was, therefore, a contract between the state and the company, and the state court had decided that the legislature did not violate or impair the obligation of any contract with the company.[1] Having determined that it had jurisdiction to review and revise the judgment of the State Supreme Court in this matter, the United States Supreme Court sustained the validity of the exemption, and the power of the legislature to exempt upon conditions or contingencies which were to happen in the future. They construed that portion of the act of incorporation which granted the exemption to have this effect: That the capital stock of the company is forever exempt from taxation during the existence of the corporation; the road and fixtures, etc., were exempt for twenty-five years after the completion of the road, which term had now expired; and now those portions of the property could be taxed only when the net earnings of the company were more than sufficient to pay to the stockholders, on the present basis of its capital, a dividend of eight per cent a year. But the court in sustaining the validity of the exemption did not mean to be understood as holding that the railroad company had the right, in its discretion, hereafter to issue additional stock, or to increase its bonded indebtedness, even for legitimate purposes, and have the same taken into consideration upon the question of its liability for taxation under the eight per cent dividend clause of the charter.[2] It appeared in this case that in the charter of a railroad company chartered in Missouri in 1857, there was a provision that its property should be exempt from taxation for a period of twenty years after its completion. Its road was completed in 1872. In 1870, under a general law of Missouri, it was consolidated with an Iowa corporation. In 1886 the consolidated road was sold under a decree of foreclosure of mortgage to purchasers who conveyed it to an Iowa corporation. The action was to charge the property in the hands of the purchaser company with a lien for state and county taxes levied on

[1] Mobile & Ohio R. R. Co. *v.* Tennessee, (1894) 153 U. S. 487.

[2] Mobile & Ohio R. R. Co. *v.* Tennessee, (1894) 153 U. S. 486. In this case the court discusses the questions of "dividends," "profits," "net profits" and what shall be deducted before the "net profits" can be determined quite at length, citing many cases.

the property of the former company in 1886. The question before the United States Supreme Court was whether the company succeeding the others by purchase at foreclosure was entitled to the exemption originally granted to the Missouri corporation in its charter. The court held that the consolidation of the Missouri corporation, under the general statute of that state, with the Iowa corporation, operated to extinguish the old company and to form a new one as of the date of the consolidation, and other provisions concerning exemption from taxation in the old charter did not pass to the new company.[1]

[1] Keokuk & Western R. R. Co. *v.* Missouri, (1894) 152 U. S. 301. As to the effect of consolidation of companies, see Tomlinson *v.* Branch, 15 Wall. 460; Philadelphia, etc., Railroad *v.* Maryland, 10 Hun, 376; Delaware Railroad Tax, 18 Wall. 206; Central Railroad *v.* Georgia, 92 U. S. 665; Chesapeake & Ohio Railroad *v.* Virginia, 94 U. S. 718; Green County *v.* Conness, 109 U. S. 104; Shields *v.* Ohio, 95 U. S. 319; Railroad Co. *v.* Maine, 96 U. S. 499; Railroad Co. *v.* Georgia, 98 U. S. 359, 362; St. Louis, Iron Mountain, etc., Railway *v.* Berry, 113 U. S. 465; McMahan *v.* Morrison, 16 Ind. 172; Memphis & Little Rock Railroad *v.* Commrs., 112 U. S. 609; Louisville & Nashville Railroad *v.* Palmes, 109 U. S. 244; Morgan *v.* Louisiana, 93 U. S. 217; Picard *v.* Tennessee, etc., Railroad, 130 U. S. 637; Tennessee *v.* Whitworth, 117 U. S. 139; Wilmington & Weldon Railroad *v.* Alsbrook, 146 U. S. 279, 297. As to exemptions, see Vicksburg & Meridian R. R. Co. *v.* Bradley, 66 Miss. 518; s. c., 6 So. Rep. 321; State *v.* Hannibal & St. Jo R. R. Co., (Mo.) 11 S. W. Rep. 746; Yazoo & M. V. R. R. Co. *v.* Board of Levee Comrs., 37 Fed. Rep. 24; Yazoo & M. V. R. R. Co. *v.* Thomas, 65 Miss. 553; s. c., 5 So. Rep. 108; State *v.* Keokuk & W. R. R. Co., 99 Mo. 30; s. c., 12 S. W. Rep. 290; Norwich & W. R. R. Co. *v.* County Commissioners, 151 Mass. 69; s. c., 23 N. E. Rep. 721; County of Stevens *v.* St. Paul, M. & M. Ry. Co., 36 Minn. 467; s. c., 31 N. W. Rep. 942; State *v.* Jersey City, (N. J.) 9 Atl. Rep. 782; Little Rock & Fort Smith Ry. *v.* Worthen, 120 U. S. 97; s. c., 7 Sup. Ct. Rep. 469; State *v.* Morris & Essex R. R. Co., (N. J.) 7 Atl. Rep. 826; Louisville & Nashville R. R. Co. *v.* Commonwealth, 89 Ky. 531; s. c., 12 S. W. Rep. 1064; Marye *v.* Baltimore & Ohio R. R. Co., 127 U. S. 117; s. c., 8 Sup. Ct. Rep. 1037; St. Paul, M. & M. Ry. Co. *v.* City of St. Paul, (Minn.) 38 N. W. Rep. 925; State *v.* Northern Pac. R. R. Co., 39 Minn. 25; s. c., 38 N. W. Rep. 635; Atlantic & P. R. R. Co. *v.* Lesueur (Ariz.) 19 Pac. Rep. 157; State *v.* Webber, (Minn.) 37 N. W. Rep. 949; Minnesota Cent. R. R. Co. *v.* Donaldson, 38 Minn. 115; s. c., 35 N. W. Rep. 725; Wisconsin Cent. R. R. Co. *v.* Comstock, 71 Wis. 88; s. c., 36 N. W. Rep. 843, following Railroad Company *v.* Price County, (Wis.) 26 N. W. Rep. 93. Exemption from taxation; when it does not pass to a purchaser at judicial sale, see Kentucky Central R. R. Co. *v.* Commonwealth, 87 Ky. 661; s. c., 10 S. W. Rep. 269; Pickard *v.* East Tennessee, Va. & Ga. R. R. Co., 130 U. S. 637; s. c., 9 Sup. Ct. Rep. 640; State *v.* Hannibal & St. Jo R. R. Co., (Mo.) 13 S. W. Rep. 505; Philadelphia, Wil. & Balt. R. R. Co. *v.* Neary, 5 Del. Ch. 600.

It has been held in Texas that the exemption from taxation by a statute, for good consideration, of property owned or to be owned by a railroad corporation or its successors, could not be withdrawn for failure to exercise corporate powers in the absence of a provision for forfeiture, as such exemption attached to the property.[1] In Mississippi, upon payment of a privilege tax, a railroad corporation is exempted from all state and county taxes except taxes on land owned by the corporation and not used in operating the road. Land owned by a railroad corporation separated by the track from the buildings of the road, not used for railroad purposes, and not necessary to its operation, has been held subject to taxation.[2] This railroad company was incorporated under an act of the North Carolina legislature with a capital stock of $3,000,000. The state subscribed for two-thirds of the shares and paid for them with six per cent bonds, the other shares being taken by private persons. By an act afterwards passed the charter of the company was amended so as to increase the capital stock to $4,000,000, the original amount being found to be insufficient to complete the road, and the state subscribed for the additional shares, paying for them with bonds as before. There was a provision in the act exempting from taxation all real estate held by the company for right of way, stations and workshops, until the dividends of profits should exceed six per cent per annum. A majority of the directors represented the state's interest. Under a tax law passed afterwards, the majority directors ordered the president to list all the property of the company for taxation. Certain shareholders filed a bill in the federal court to enjoin the president from such listing of the property. Simonton, Circuit Judge, held that the exemption provided for in the act amending the charter of the railroad company was a part of the contract between the state and the corporation, and that acts of the general assembly of North Carolina repealing that provision of the charter and providing for the listing of such property for taxation were void, as impairing the obligations of a contract.[3] It was held, therefore, that the majority of the board

[1] International & Great Northern Ry. Co. *v.* State, 75 Tex. 256; s. c., 12 S. W. Rep. 685.

[2] Lewis *v.* Vicksburg & Meridian R. R. Co., (Miss.) 6 So. Rep. 773.

[3] Barnes *v.* Kornegay, (1894) 62 Fed. Rep. 671. It was said: "The precise question arose in Tomlinson *v.* Jessup, 15 Wall. 458. A railroad company had obtained its charter and com-

of directors of this railroad company could not list for taxation the property exempted by the act amending the company's charter, against the protest of the minority stockholders.[1] And this majority of the directors representing the state having done everything they could as a board to surrender or destroy such exemption, in the face of the protest of the minority, and the governor and the state desiring such surrender, the bill of the minority stockholders was maintainable for the injunction prayed, without first going to the board of directors and endeavoring to induce them to prevent such taxation.[2] In a case before the United States Circuit Court for the eastern district of Louisiana, it appeared that by the charter of the bank which it was sought to collect taxes from by the state, the state had loaned several millions of dollars of its bonds to the bank, which bonds constituted the capital of the bank, were indorsed by it and sold. The stockholders were not immediately to pay anything upon their subscriptions, but were to furnish mortgages upon their plantations and slaves, which mortgages were to be held as security for payment of the lands and bear a certain interest. Certain duties were besides imposed upon the bank in the construction of certain public works to be afterwards turned over to the state. The profits were not distributable except to a limited amount until the payment of the bonds of the state was made. The stock, securities and profits of the bank were practically pledged for the

pleted its road under an act of the legislature containing no exemption from taxation. Some years afterwards it obtained an amendment to its charter, and in the amending act was the exemption. The state adopted a new Constitution, and in that Constitution it was sought to repeal all such exemptions. The Supreme Court of the United States, having these facts under consideration, says: 'In these cases, and in others of a similar character, the exemption is upheld as being made upon considerations moving to the state, which gives to the transaction the character of a contract. It is thus brought within the provisions of the Federal Constitution. In the case of a corporation, the exemption, if originally made in the act incorporating it, is supported upon the consideration of the duties and liabilities which the corporation assumes by accepting the charter. When made, as in the present case, by an amendment of the charter, it is supported upon the consideration of the greater efficiency with which the corporation will thus be enabled to discharge the duties originally assumed by the corporation to the public, or of the greater facility with which it will support its liability and carry out the purposes of its creation.'"

[1] Barnes *v.* Kornegay, (1894) 62 Fed. Rep. 671.

[2] Barnes *v.* Kornegay, (1894) 62 Fed. Rep. 671.

payment of the bonds. The act incorporating the bank exempted the capital of the bank from taxation "during the continuance of its charter." The court construed this exemption, as it was granted for the purpose of facilitating the repayment to the state of the capital advanced to the bank in the state's bonds, to continue not only for the duration of the bank's charter as then fixed, but for as long as the charter should exist as extended by the state at any future time, for the purpose of securing the repayment of such advances." and the charter having been extended in 1874, the exemption continued, notwithstanding the denial to the legislature by the Constitution of the state then in force of the power of exempting property from taxation, except such as was used for church, school or charitable purposes.[1] The legislature of Louisiana, in 1880, had passed an act authorizing this bank "to compromise and settle the liability of the mortgage stockholders of said bank arising out of the stock mortgages granted by them to secure their subscriptions to the capital stock of said bank, said compromises to be made when deemed judicious by said bank and with the assent of the bondholders," etc. The act also made provision "that all sums realized from said compromise, as well as from the enforcement of said mortgages by the usual legal proceedings, shall be held and applied by the banking department of said bank to the satisfaction of the bonds of the state, issued in aid of the bank, and to the legal liabilities of said mortgage stock department, and to the necessary expenses of said department." The tax officers in the case before the court claimed that the bank had waived its rights to exemption by assenting to the conditions included in the fourth section of this act which were to this effect: "That this act shall not be binding or confer any right upon the bank unless accepted within twelve months from the date of this act, and under the conditions prescribed in articles 234 and 237 of the Constitution. * * * " Article 234 is as follows: "The general assembly shall not remit the forfeiture of the charter of any corporation now existing, nor renew, alter or amend the same, nor pass any general or special law for the benefit of such corporation, except upon the condition that such

[1] Citizens' Bank of Louisiana *v.* Board of Assessors for the Parish of Orleans, (1893) 54 Fed. Rep. 73. The court in its argument upon this point refers to Tennessee *v.* Whitworth, 117 U. S. 145; s. c., 6 Sup. Ct. Rep. 649; Bank *v.* Bouny, 32 La. Ann. 245.

corporation shall hereafter hold its charter subject to the provisions of this Constitution." The court held that as it appeared that it would have been disastrous to the interests of the state to attempt to enforce those mortgages given by the stockholders, the act of the legislature authorizing a compromise of those oblitions was for the benefit of the state and ultimately to secure the payment of the bonds, and, therefore, not a privilege or favor granted to the bank, for the legislature had no authority to impose upon the bank the condition that its exemption from taxation should be thereafter waived; and though the bank intended, by acceptance of the act, to waive the exemption, the attempt to do so was of no effect, the capital of the bank being still exempt from taxation.[1] In this case a corporation which had been engaged in manufacturing in New Jersey, which had carried on business for a certain period, but afterwards ceased, the state having imposed a tax upon it because it was not engaged in the active business of manufacturing, claimed exemption under the statute passed in that state April 18, 1884.[2] The court held that, to bring itself within the immunity against taxation accorded by that statute to manufacturing corporations, the corporation must be actively engaged in the business of manufacturing.[3]

§ 580. Taxation of corporations — rules in New York.— In a case where a New Jersey corporation was assessed for taxation upon its moneys and property in the state of New York, it claimed that the amount of its debts should be deducted. The New York Court of Appeals held that foreign corporations were included within the statute of New York,[4] which provides as follows: "All persons and associations doing business in the state of New York as merchants, bankers or otherwise, either as principals or partners, whether special or otherwise, and not residents of this state, shall be assessed and taxed on all sums invested in

[1] Citizens' Bank of Louisiana *v.* Board of Assessors of the Parish of Orleans, (1893) 54 Fed. Rep. 73.

[2] Rev. Supp. N. J. 1017.

[3] State, Edison Phonograph Co., Prosecutor, *v.* State Board of Assessors, (1895) 55 N. J. L. 55; citing Construction Co. *v.* Board of Assessors, 53 N. J. L. 564. The court said: "A corporation wishing to withdraw from active business must, to escape taxation, take proceedings under the thirty-fourth section of the Corporation Act to dissolve and surrender its charter and wind up its affairs; but if it elects to continue its existence and retain its franchises, it must be subject to the tax which has been levied in this case (a tax upon its capital stock)."

[4] 1 N. Y. L. 1855, chap. 37.

any manner in said business the same as if they were residents of this state, and said taxes shall be collected from the property of the firms, persons or associations to which they severally belong."[1] As to the right to deduct debts it was said: "We are of the opinion that this act does not contemplate the deduction of debts from the sums invested in this state by non-residents. As the person is a non-resident, it is to be assumed that he will, at the place of his domicile, have all of what might be termed his equities adjusted, and that, if entitled to it anywhere, it will be at such domicile that he will claim and be allowed to have the right to have such deduction. In his case the statute of 1855 seizes upon the certain specific sum which he has here invested in the business carried on by him, and that sum is to be assessed and taxed the same as if the person were a resident of the state. In using the expression 'the same as if they were residents of this state,' we do not think it was intended that exceptions were to be allowed here the same as if the party were a resident, or that deductions from the sum thus invested should be made as if that were the case. It meant, as it seems to us, that the sum invested in any manner in business in this state should be assessed in the same manner and form as a resident would be assessed."[2] In this case the Court of Appeals of New York reversed the General Term of the Supreme Court, which affirmed the dismissal by the Special Term of a *certiorari* on the part of a manufacturing corporation to review an assessment of its property made by the commissioners of taxes and assessments of the city of New York. It appeared that the assessment was based solely upon statements of the corporation in answer to questions put by the commissioners, which statements showed that the capital of the corporation was impaired, and that the indebtedness of the company exceeded the value of its assets, exclusive of real estate, and did not disclose any fact or circumstance justifying a disbelief of the answer made, except that a dividend had been declared and paid shortly previous to the statement made. The court held that this statement as to a dividend having been declared did not authorize a disbelief in the statement of the impairment of capital, and, in the

[1] People ex rel. Thurber-Whyland Leather Co. *v.* McLean, 80 N. Y. Co. *v.* Barker, (1894) 141 N. Y. 118; 254, 259.
citing British Com'l Life Ins. Co. *v.* [2] People ex rel. Thurber-Whyland Commrs. of Taxes, 1 Keyes, 303; cited Co. *v.* Barker, (1894) 141 N. Y. 118, in People ex rel. Bay State Shoe & 121.

absence of any request on the part of the commissioners for further information, did not justify them in imposing a tax, as the statements, if accepted as true, showed that there was no basis for imposing the tax.[1] Under the provisions of the New York Corporation Tax Act,[2] giving to the state comptroller power to revise and adjust any account theretofore settled against a corporation for taxes arising under the act, and authorizing a review by *certiorari* of the action of the comptroller, relief may be given as provided where a tax has been imposed upon and paid by a corporation which was exempt from any taxation under the act. And the corporation will not be deprived of the relief granted by the statute by reason of the fact that the payment was not made under coercion.[3] Under New York statutes relative to the taxation of capital stock of corporations, the actual value and not the market value of its stock must be assessed.[4] The capital and surplus, and not the share stock, is the subject of valuation in assessing a corporation.[5] A corporation cannot be taxed upon stock of another corporation held by it, where the capital of the latter is taxable.[6] It is legal error to refuse to decide in accordance with evidence presented by a corporation to taxing officers as to the value of the corporation's assets, the evidence being so full and complete as to establish the basic facts upon which its claim for reduction of tax rests, it not being contradicted by facts within the knowledge of the taxing officers, and they having no good reason to doubt the truth of the evidence.[7] The indebtedness of a corporation should be deducted from the valuation of

[1] People ex rel. Edison General Electric Co. *v.* Barker, (1894) 141 N. Y. 251.

[2] N. Y. Laws, 1880, chap. 542; amended, N. Y. Laws, 1889, chap. 463.

[3] People ex rel. Edison Electric Illuminating Co. of New York *v.* Wemple, (1894) 141 N. Y. 471. See People, etc., *v.* Wemple, 133 N. Y. 617.

[4] People *v.* Barker, 146 N. Y. 304; s. c., 40 N. E. Rep. 996.

[5] United States Trust Co. *v.* Mayor, etc., of New York, 77 Hun, 182; s. c., 28 N. Y. Supp. 344; 59 N. Y. St. Repr. 496. See Trimmer *v.* City of Rochester, 130 N. Y. 401; People ex rel. Union Trust Co. *v.* Coleman, 126 N. Y. 433; National Bank of Chemung *v.* City of Elmira, 53 N. Y. 49; Re New York Catholic Protectory, 77 N. Y. 342; McLean *v.* Jephson, 123 N. Y. 143.

[6] People ex rel. Brooklyn Traction Co. *v.* Board of Assessors, 61 N. Y. St. Repr. 480; s. c., 30 N. Y. Supp. 448.

[7] People ex rel. German Looking Glass Plate Co. *v.* Barker, 75 Hun, 6; s. c., 26 N. Y. Supp. 971; 57 N. Y. St. Repr. 1. See People ex rel. Edison Electric Illuminating Co. *v.* Barker, 139 N. Y. 55.

its corporate assets in assessing its capital stock.[1] In assessing a corporation for taxation, the deduction of "non-taxable assets" has been held to be illegal.[2] There is no authority in the comptroller of the state of New York to impose a tax on real estate in the state, purchased by a corporation from its surplus as an investment, and not used in its business.[3] The capital of a domestic corporation of New York, invested in real estate in another state, in bonds of the United States deposited under a deed of trust in another state and in a foreign country with the minister of finance, to enable it to do business in the other state and foreign country, as required by the laws of the state and country, have been held not to be capital employed in the state of New York, subject to taxation, notwithstanding the fact that the interest upon the bonds was received and used in New York, and all the property was subject to the claims of all creditors of the corporation.[4] Property assessed for taxation may be released from the assessment by the legislature, its power over the subject being unlimited and exercisable in any way, and at any time before the taxes assessed are paid.[5] A special statute exempting the property of a corporation from local taxation, the exemption includes taxation from county as well as city purposes.[6] Foreign corporations have been held not to be entitled to a deduction of

[1] People ex rel. Second Avenue R. R. Co *v.* Barker, 141 N. Y. 196; s. c., 56 N. Y. St. Repr. 834.

[2] People ex rel. W. & J. Sloane *v.* Barker, 76 Hun, 454; s. c., 27 N. Y. Supp. 1082; 58 N. Y. St. Repr. 495. See People *v.* Ryan, 88 N. Y. 142.

[3] People ex rel. Singer Manufacturing Co. *v.* Wemple, 78 Hun, 63; s. c., 29 N. Y. Supp. 92; 60 N. Y. St. Repr. 662. See Williams *v.* Western Union Telegraph Co., 93 N. Y. 162; Burrall *v.* Bushwick R. R. Co., 75 N. Y. 211; Barry *v.* Merchants' Exchange Co., 1 Sandf. Ch. 280; Barclay *v.* Culver, 30 Hun, 1; People ex rel. Southern Cotton Oil Co. *v.* Wemple, 131 N. Y. 64; People *v.* American Bell Telephone Co., 117 N. Y. 241.

[4] People ex rel. American Surety Co. *v.* Campbell, 74 Hun, 101; s. c., 26 N. Y. Supp. 462. *Cf.* People *v.* New England Mut. Life Ins. Co., 26 N. Y. 303; People ex rel. Postal Telegraph Cable Co. *v.* Campbell, 24 N. Y. Supp. 208; People ex rel. American Contracting, etc., Co. *v.* Wemple, 129 N. Y. 558.

[5] People ex rel. American Bible Society *v.* Comrs. of Taxes & Assessments, 142 N. Y. 348. See Sisters of St. Francis *v.* Mayor, etc., of New York, 112 N. Y. 677; Association for Colored Orphans *v.* Mayor, etc., of New York, 104 N. Y. 581.

[6] People ex rel. Pratt Institute *v.* Board of Assessors of Brooklyn, 141 N. Y. 476. In 19 Abb. N. C. 231, will be found a note on the exemption of religious corporations from taxation. The statute of New York, Laws N. Y. 1892, chap. 399, § 2, in favor of religious corporations as to

their indebtedness, in the assessment of their property invested in business in the state of New York, though the indebtedness may be due within the state.[1]

§ 581. Taxation of corporations — rules in Pennsylvania. — Under the laws of Pennsylvania imposing a tax upon the indebtedness, as bonds, mortgages, etc., of corporations, the corporation is not liable for tax on so much of its indebtedness as may be held and owned by Pennsylvania corporations in their own right, or by persons not citizens of or residing in that state.[2] The statute making it the duty of the treasurer of the corporation to assess and retain and pay over to the state the tax imposed by the law under which these taxes were claimed upon indebtedness of the corporation on so much of indebtedness as was held by residents of that state, the corporation was held liable for his failure or neglect to do so.[3] Certain taxes were imposed upon a New York corporation, which had also been granted the privilege of constructing and operating a portion of its road through Pennsylvania, under the statute of Pennsylvania (P. L. Pa. 1885, 193, § 1), which assessed an annual tax of three mills on the dollar for state purposes, on all mortgages, money owing by solvent debtors, whether by promissory note or penal or single bill, bond or judgment, also all articles of agreement and accounts bearing interest, owned or possessed by any person or persons whatsoever (except notes or bills for work or labor done, and obligations given

exemptions from taxation applies only to corporations incorporated in the state of New York. Matter of Fayerweather, 31 Abb. N. C. 287; s. c., 30 N. Y. Supp. 273, following Matter of Prime, 136 N. Y. 347; Vanderpoel *v.* Gorman, 140 N. Y. 563. 575. As to the limit of the exemption of manufacturing corporations, foreign or domestic, doing business in the state of New York, see People ex rel. Tiffany & Co. *v.* Campbell, 80 Hun, 95; s. c., 30 N. Y. Supp. 70; 61 N. Y. St. Repr. 811, distinguishing People ex rel. Seth Thomas Clock Co. *v.* Wemple, 133 N. Y. 323; People *v.* Horn Silver Mining Co., 105 N. Y. 76. As to an exemption from taxation which was held erroneous, see Matter of Tiffany & Co., 80 Hun, 486; s. c., 30 N. Y. Supp. 494. When the exemption is not operative, see People ex rel. Western Electric Co. *v.* Campbell, 80 Hun, 466; s. c., 30 N. Y. Supp. 472.

[1] People *v.* Barker, 33 N. Y. Supp. 1019; People *v.* Barker, 86 Hun, 148; s. c., 33 N. Y. Supp. 221. As to the effect of voluntary payment of tax upon the right to recover it back, see United States Trust Co. *v.* Mayor, etc., of New York, 77 Hun, 182; s. c., 28 N. Y. Supp. 344; 59 N. Y. St. Repr. 496.

[2] Commonwealth *v.* Wilkesbarre & Scranton Railway Co., (1893) 14 Pa. Co. Ct. Rep., 205.

[3] Ibid.

to banks for money loaned and bank notes), on all public loans or stocks (except those issued by Pennsylvania or the United States), on all moneys loaned or invested in any other state and on all other moneyed capital in the hands of individual citizens of Pennsylvania, the property and interests so taxed being exempted from all taxation, except for state purposes, and the act not to apply to building or loan associations. Upon a writ of error from the Supreme Court of the State of Pennsylvania, which had affirmed the judgment of a lower court sustaining the taxes, the question presented to the Supreme Court of the United States was whether the commonwealth of Pennsylvania might, consistently with the Constitution of the United States, impose upon the railroad company the duty — when paying *in the city of New York* the interest due upon scrip, bonds or certificates of indebtedness held by residents of Pennsylvania — of deducting from the interest so paid the amount assessed upon bonds and moneyed capital in the hands of such residents of Pennsylvania. The court held that it could not. Also, that the section of that act making it "the duty of the treasurer of each private corporation, incorporated by or under the laws of this commonwealth, or the laws of any other state, or of the United States, and doing business in this commonwealth, upon the payment of any interest on any scrip, bond or certificate of indebtedness, issued by said corporation to residents of this commonwealth, and held by them, to assess the tax imposed and provided for state purposes upon the nominal value of each and every said evidence of debt, etc.," impaired the obligation of the contract originally made by the New York corporation and the state of Pennsylvania, as disclosed by those statutes, authorizing the construction of its road, etc., and by what was done by the companies, upon the faith of those acts.[1] When an insurance corporation of Pennsylvania, at the time of its dissolution by decree of the court, is a debtor to the state for tax on gross premiums, the debt continues to exist and is a charge on the assets passing into the hands of the receiver under the statute of 1876 of that state. And such a corporation is liable on the principle of apportionment only for the tax on the

[1] New York, L. E. & W. R. R. Co. *v.* Pennsylvania, (1894) 153 U. S. 628. The court did not consider State Tax on Foreign-held Bonds, 15 Wall. 300, 320, as controlling, and distinguished Bell's Gap Railroad Co. *v.* Pennsylvania, 134 U. S. 232; reaffirmed in Jennings *v.* Coal Ridge Improvement & Coal Co., 147 U. S. 147.

gross premiums received up to the time it is dissolved and not for the full six months.[1] One of the Courts of Common Pleas of Pennsylvania, in construing the Tax Act of that state of 1891, imposing taxes upon the capital stock of corporations, has declared the following rules: Only so much of the income of a corporation — whether called net earnings or amount of profit made — as is either declared in dividends or carried into surplus or sinking fund, is made the measure of the minimum price or value of the capital stock by the act referred to.[2] The amount of profit made, and either declared in dividends or carried into surplus or sinking fund, does not furnish an absolute measure of the actual value in cash of the capital stock of a corporation, but is to be considered, with all other pertinent facts, in determining what is its actual value in cash.[3]

§ 582. Privilege tax.— A franchise tax imposed upon a corporation as the price of the right and privilege of being a corporation, may be exacted by the state granting the franchise, no matter how the corporate property may be invested or employed, or where it may be situate.[4] Such a tax levied upon a manufacturing corporation of New Jersey was held not to be inconsistent with the terms of its charter which exempted from taxation "the real and personal property of the said corporation not actually in fact within the state of New Jersey, and the stock of the said corporation held or owned by any of its stockholders."[5] The

[1] Commonwealth *v.* American Life Insurance Co., (1893) 14 Pa. Co. Ct. Rep. 216. See, on the second ruling, Commonwealth *v.* Standard Oil Co., 101 Pa. St. 119; Commonwealth *v.* Pennsylvania Coal Co., 41 Leg. Int. 125; Commonwealth *v.* Western Union Telegraph Co., 15 W. N. C. 331; Pullman's Palace Car Co. *v.* Commonwealth, 107 Pa. St. 156; Commonwealth *v.* Canal Co., 50 Pa. St. 410; Commonwealth *v.* American Machine Co., 2 Ches. Co. 186.

[2] Commonwealth *v.* Edgerton Coal Co., (1893) 14 Pa. Co. Ct. Rep. 449, following Commonwealth *v.* Sharon Coal Co., Limited, (1893) 14 Pa. Co. Ct. Rep. 222. As to definitions of "net earnings" and "income," see Jones Mfg. Co. *v.* Commonwealth, 69 Pa. St. 137; Commonwealth *v.* Penn Gas Coal Co., 62 Pa. St. 241; Eyster *v.* Centennial Board of Finance, 94 U. S. 503.

[3] Commonwealth *v.* Edgerton Coal Co., (1893) 14 Pa. Co. Ct. Rep. 449.

[4] Honduras Commercial Company *v.* State Board of Assessors, (1892) 54 N. J. L. 278.

[5] The State, Singer Manufacturing Co., Prosecutor, *v.* Heppenheimer, (1892) 54 N. J. L. 439. The court said: "The question is evidently one of statutory construction in each case. Admit that an exemption of the company or its property, nothing else appearing, implies an exemption of the shares of its capital stock, and that an exemption of the shares, nothing else appearing, implies an exemption of the company and its property, yet it is certainly within the power of the legislature to exempt the company or its property, and reserve the right to tax the company and its property. The corporation and the individual stockholders are obviously not included under the same description, nor are their rights identical (State *v.* Powers, 4 Zab. 400); both may be taxed, or either, as the legislature wills. State *v.* Branin, 3 Zab. 484. If, therefore, it appears by the charter of the prosecutor that the legislature in exempting the shares of its capital stock held or owned by individuals, did not mean to exempt the company or property, the decisions cited from 3 Zabriskie and 4 Zabriskie, become inapplicable, and the legislative purpose must prevail. Such a purpose is, I think, to be gathered from a consideration of all the provisions of the company's charter. In conjunction with the clause exempting the shares is an express exemption of the real and personal property of the corporation not actually within the state. Not only is this exemption superfluous, if the exemption of the shares was understood to relieve from taxation all the corporate property, but this express immunity conceded to property outside of the state affords the clearest implication that the taxability of corporate property within the state was to be preserved. Thus the implication which was countenanced in the former decisions is repelled by the statute now under review. The legislative intent, plainly embodied in this company's charter, is to relieve from taxation the shares of stock in the hands of its stockholders, but to reserve the right of levying upon the corporation itself any legal imposition except a tax on its real or personal property outside of New Jersey. The present tax, being levied upon the company for the exercise of its franchises within the state, comes under the reservation."

New Jersey Supreme Court on *certiorari* has upheld the yearly license fee imposed upon miscellaneous corporations imposed under the statute of April 18, 1884,[1] to which an objection was made that it was a levy upon interstate commerce, and, therefore, in violation of the Federal Constitution.[2] The United States

[1] N. J. Rev. Suppl. p. 1016.

[2] Lumberville Delaware Bridge Co. *v.* State Board of Assessors, (1893) 55 N. J. L. 529, citing in support of the holding, Robbins *v.* Shelby County, 120 U. S. 489; Leloup *v.* Mobile, 127 U. S. 648; The State Freight Tax, 15 Wall. 232; Railroad Co. *v.* Husen, 95 U. S. 465; Cook *v.* Pennsylvania, 97 U. S. 566; Brown *v.* Houston, 114 U. S. 622; Lyng *v.* Michigan, 135 U. S. 161; Norfolk & Western R. R. Co. *v.* Pennsylvania, 136 U. S. 115; Fargo *v.* Michigan, 121 U. S. 230; Crutcher *v.* Kentucky, 141 U. S. 47; Philadelphia St. Ship Co. *v.* Pennsylvania, 122 U. S. 326; Moran *v.* New Orleans, 112 U. S. 69; Pickard *v.* Pullman Southern Car Co., 117 U. S. 34; Pensacola Telegraph Co. *v.* Western Telegraph Co., 96 U. S. 1; Western Union Telegraph Co. *v.* Texas, 105 U. S. 460; Wabash, St. L. & Pac. Ry. Co. *v.* Illinois, 118 U. S. 557; Western Union Telegraph Co. *v.* Pendleton, 122 U. S. 347; Ratterman *v.* Western Union Telegraph Co., 127 U. S. 411; Wiggins Ferry Co. *v.* East St. Louis, 107 U. S. 365; Maine *v.* Grand Trunk Railway Co., 142 U. S. 217; Packet Co. *v.* Keokuk, 95 U. S. 80; Packet Co. *v.* St. Louis, 100 U. S. 428; Packet Co. *v.* Catlettsburg, 105 U. S. 563; Transportation Co. *v.* Par-

Supreme Court considered a statute of Ohio, under which there was imposed upon a railroad company a fee to the state, and held that if several railroad corporations, each existing under the laws of separate states, consolidate into one corporation, the statute of one of the states imposing a charge upon the new consolidated company of a percentage on its entire authorized stock as the fee to the state for the filing of the articles of consolidation in the office of the secretary of state, without which filing it could not possess the powers, immunities and privileges which appertain to a corporation in that state, was not a tax on interstate commerce, or the right to carry on the same, or the instruments thereof; and that its enforcement involved no attempt on the part of the state to extend its taxing power beyond its territorial limits.[1]

kersburg, 107 U. S. 698; Ouachita Packet Co. *v.* Aiken, 121 U. S. 444; Coe *v.* Errol, 116 U. S. 517; Western Union Telegraph Co. *v.* Massachusetts, 125 U. S. 530; Pullman Palace Car *v.* Pennsylvania, 141 U. S. 18; Delaware Railroad Tax Case, 18 Wall. 206; Horn Silver Mining Co. *v.* New York, 143 U. S. 305; Minot *v.* Philadelphia, Wilmington & Baltimore R. R. Co., 18 Wall. 206; State Tax on Railway Gross Receipts, 15 Wall. 284. The New Jersey court said: "The franchise that is taxed as property is the privilege enjoyed by a corporation of exercising certain powers derived from the state, whereas the franchise with which we have to do is the right to exist in corporate form without reference to the powers that under such form the company may exercise. This distinction, although formulated by Mr. Justice FIELD in Home Insurance Co. *v.* New York, 134 U. S. 594, was not strictly adhered to in his subsequent expressions, probably because there was nothing in that case to call for a nice use of terms. In this state we tax each of these so-called franchises. The power, as in the case of the right to own and operate a railroad is taxed as property having a true value, which it is the duty of the state board to ascertain for the purposes of constitutional assessment. On the other hand, the naked right of existing in corporate forms is taxed as in the case before us, not at its true value, as it would have to be if it were property, but at a sum arbitrarily imposed by the legislature as an annual fee, the amount of which is to be computed by reference to the capital of the company as a criterion. It is, in short, a poll tax levied upon domestic corporations for the right to be. Such a tax is not upon property or assets and does not in any way concern the nature of the business the company may be authorized to carry on. If the business chance to be one of commercial intercourse with other states, the burden incidental to corporate existence does not, under the federal decisions [already] cited, constitute a regulation of that commerce."

[1] Ashley *v.* Ryan, (1894) 153 U. S. 436. The court said: "As it was within the discretion of the state to withhold or grant the privilege of exercising corporate existence, it was, as a necessary resultant, also within its power to impose whatever conditions it might deem fit as prerequisite to corporate life. The act of filing, constituting, as it did, a claim of a right to the franchise granted by the state law, carried with it a voluntary assumption of any burden with which the privilege was accompanied, and without which the right to corporate existence could not have been procured. We say *voluntary* assumption, because, as the claim to the franchise was voluntary, the assumption of the privilege which resulted from it partook necessarily of the nature of the claim for corporate existence. Having thus accepted the act of grace of the state, and taken the advantages which spring from it, the company cannot be permitted to hold on to the privilege or rights granted and at the same time repudiate the condition by the performance of which it could alone obtain the privilege which it sought."

[1] Lumberville Delaware Bridge Co. *v.* State Board of Assessors, (1893) 55 N. J. L. 529. The court, referring to Easton Delaware Bridge Co. *v.* Metz, Collector, 32 N. J. L. 199, which suggested the contention, said: "That case has, however, no application. The tax there considered was imposed directly upon the capital and surplus which, so the court held, was intended by the legislature to embrace one-half of an enterprise resting in dual legislation. Since the last amendments of the Constitution such a tax is a legal impossibility, and the construction placed by the court upon the legislative intent with respect to the amount of property to be embraced in the tax is no aid in the present case, where the tax is not upon capital or property put to the common use of a domestic and a foreign organization, but is the price the domestic company must pay for the right of corporate life. Such a right is in its nature indivisible, and the fee, therefore, must necessarily be an entirety. In computing such a fee the board of assessors has no discretion — the legislative mandate is plain and cannot be departed from by the assessors nor modified by the courts. In The Evening Journal Association *v.* The State Board of Assessors, 47 N. J. L. 36, the business in which the capital of the corporation was invested was considered by this court for the purpose of determining whether it was a "manufacturing company" within the meaning of the statute. And in The Press Printing Company *v.* The State Board of Assessors, 51 N. J. L. 75, the court, finding that the corporation was in one sense and as to a distinct part of its capital a manufacturing company, adopted as the criterion for the ascertainment of the amount of

§ 583. Computation of such tax — rule. — There was also an objection in this case to the manner of computing the tax, the contention being that inasmuch as the erection of the bridge was a joint enterprise requiring the concurrent legislation of two states, the capital to be taken as the criterion of the license fee should be one-half of the capital the domestic corporation was authorized to have. The court sustained the mode of computing the tax upon the total capital of the corporation.[1]

§ 584. Taxation of banks and shares of bank stock — rules. — On *certiorari* the Supreme Court of New Jersey set aside taxes imposed upon shares of stock held by the prosecutor in a foreign corporation, having its principal place of business in

another state, it appearing that taxes had been actually assessed in the other state, and paid by the corporation, within twelve months before the day prescribed by law for commencing the assessment of taxes in New Jersey, holding them exempt from taxation in that state. They also set aside the taxes imposed upon his shares of stock in a national banking association located in another state, holding that they could not be taxed under the laws of New Jersey.[1] The laws of Washington, providing for the assessment of bank stock for taxes, make bankers the agents for their respective shareholders, and authorize the collection from each bank of taxes upon its stock as assessed against it as such agent. The assessments upon the stock or shares of the shareholders in this case were assessed separately against each shareholder. The bank was not charged upon the assessment roll as agent for its shareholders, nor charged at all for any tax upon its stock, nor even referred to by its proper corporate name in the assessments against its several shareholders. The bank brought this suit against the treasurer of the county to restrain the collection of the tax from the bank. The United States Circuit Court overruled a demurrer to the bill, holding that under the above state-

the tax which, under the act of 1881 (Rev. Supp. p. 602), the court was required to impose, the capital of the corporation not within the exemption. In the present case no such questions arise."

[1] The State, De Baun, Prosecutor, *v.* Smith, Collector of Washington Township, (1892) 55 N. J. L. 110. Upon this last ruling it was said: "The federal statute for the organization of banking associations permits shares in them to be taxed under authority of the state within which the bank is located, and expressly provides that shares owned by non-residents of the state may be taxed in the city or town where the bank is located, and not elsewhere. This statute, by fair construction, excludes all state taxation of the shares of stock except such as it expressly permits, and this exclusion is constitutional and valid. Van Allen *v.* The Assessors, 3 Wall. 573; North Ward National Bank *v.* City of Newark, 39 N. J. L. 380. Consequently shares of stock in a national banking association cannot be taxed by any state except that within which the bank is located; they are withdrawn from taxation under the authority of other states. Tappan *v.* Merchants' National Bank, 19 Wall. 490." Upon the first ruling, see The State, Smith, Prosecutor, *v.* Ramsey, Collector, etc., (1892) 54 N. J. L. 546. As to the right of a state to tax shares of stockholders in national banking associations within its limits, see Van Slyke *v.* Wisconsin, (1871) 154 U. S. 581, following National Bank *v.* Commonwealth, 9 Wall. 353; Lionberger *v.* Rouse, 9 Wall. 468. As to the state's power to legislate as to taxation of bank shares and fix the situs of the stock for purposes of taxation, see Stockholders of Bank of Abingdon *v.* Supervisors of Washington County, (1891) 88 Va. 293; Tappan *v.* Merchants' National Bank, 19 Wall. 490.

ment of facts the warrant to the collector conferred no authority upon him to seize the property of the bank for the purpose of enforcing payment of the taxes charged against the individual shareholders; neither did the law authorize the bank to pay said taxes, and charge the same to the shareholders. The court also said: "Unjust discrimination in the valuation of national bank stock, as compared with the assessment of other moneyed capital in the hands of individual citizens of the state, is prohibited.[1] Nor did the failure of the bank to make and keep good a tender of so much of the tax as was justly due bar such relief, where nothing was due from the bank, there being no assessment against it, and the county officers having declared that they would not accept less than the whole amount levied.[2] Shareholders of national bank stock have this statute as a guaranty that they cannot be taxed upon their stock heavier than other moneyed capital in the state; and when appealed to in their behalf, the courts are bound to give effect to the law. If inequality is shown to the prejudice of shareholders, either the assessment must be declared to be entirely void, or at least the excess of the tax above the rate imposed upon other moneyed capital must be abrogated.[3] A court of equity is the proper forum to grant relief, and an injunction is the proper remedy."[4] It was also held that failure to exhaust the means of redress afforded by the laws of Washington for equalization of assessments did not preclude a national bank from obtaining relief in a federal court in the state, against the collection from it of taxes on its stock, on the ground of unjust discrimination in the valuation of such stock.[5] A portion of the capital stock of a national bank in Iowa being invested in real estate, and such real estate being assessed for taxation, the Supreme Court of that state held that the stock of the bank could be taxed to the extent only of such proportion of its market value as might remain after deducting therefrom the actual value of the real estate.[6] It was also held by the Supreme Court in this

[1] Rev. St. U. S. § 5219.

[2] First Nat. Bank of Walla Walla *v.* Hungate, (1894) 62 Fed. Rep. 548.

[3] Citing People *v.* Weaver, 100 U. S. 539; Pelton *v.* Bank, 101 U. S. 143; Cummings *v.* Bank, 101 U. S. 153; Boyer *v.* Boyer, 113 U. S. 689; s. c., 5 Sup. Ct. Rep. 706; Puget Sound Nat. Bank *v.* King Co., 57 Fed. Rep. 433.

[4] First Nat. Bank of Walla Walla *v.* Hungate, (1894) 62 Fed. Rep. 548.

[5] First Nat. Bank of Walla Walla *v.* Hungate, (1894) 62 Fed. Rep. 548; Andrews *v.* King Co., 1 Wash. St. 46; s. c., 23 Pac. Rep. 409, followed.

[6] First National Bank of Albia *v.* City Council of Albia, (1892) 86 Iowa, 28. It was said in the opinion of the

case, which was a tax imposed upon shares in the stock of a national bank, that the shares were credits within the meaning of the Code of Iowa, section 814, entitling a taxpayer to deduct, from the gross amount of his credits listed for taxation, all debts owing to him in good faith.[1] Shares of stockholders in national banking.

court: "Section 5219 of the federal statutes authorizes the states to tax these banks, and contains the restriction 'that the taxation shall not be at a greater rate than is assessed on other moneyed capital in the hands of individual citizens of such state.' The same statute authorizes the taxation of the real estate held by such banks 'to the same extent, according to its value, as other real estate is taxed.' It is said in National State Bank *v.* Young, 25 Iowa, 311, 314: 'The shares of the stockholders represent the capital of the institution. To tax the shares and also the property of the bank would be double taxation.' People *v.* Weaver, 100 U. S. 539; 1 Desty on Taxation, pp. 199, 200, 379, 383. See, also, Tallman *v.* Treasurer of Butler Co., 12 Iowa, 531, where the court said: 'The shares of stockholders are theoretically, if not practically, measured in value by the property of the corporation. * * * However held [the lands], whether in fee or otherwise by the company, they are a part of the capital — affect the value of the stock which is taxable through the shares. To tax the land and the stock also which represents it, and which is enhanced by the value of the land, it seems to us would be double taxation.' In the case of In re Appeal of Des Moines Water Co., 48 Iowa, 324, 333, it is held the stock of a corporation must be taxed as the property of the corporation owners, and the question as to whether both the shares and the corporate property shall be taxed at the same time was not determined. In Cook *v.* City of Burlington, 59 Iowa, 251, the case last cited is approved, and a majority of the court held that the property of a corporation may be taxed, and that, at the same time, the stock can be taxed to the individual owners; and after citing Tallman *v.* Treasurer of Butler Co., 12 Iowa, 534; United States Express Co. *v.* Ellyson, 28 Iowa, 370, 378; McGregor's Exrs. *v.* Vanpel, 24 Iowa, 436, the court further says that it has never held 'that what is denominated 'duplicate taxation' is in excess of the legislative power. The most that can be said of these utterances of the courts is that it should be held in disfavor by courts and legislatures.' In Henkle *v.* Town of Keota, 68 Iowa, 338, the doctrine announced in Des Moines Water Co.'s Appeal and Cook *v.* City of Burlington is approved, and it is expressly held that shares of stock in a bank incorporated under the state law were taxable to the shareholders." The court cited in support of the ruling in the text People *v.* Weaver, 100 U. S. 539; Supervisors *v.* Stanley, 105 U. S. 305; 1 Desty on Taxation, 383.

[1] First National Bank of Albia *v.* City Council of Albia, (1892) 86 Iowa, 28. The court said: "In Equitable Life Ins. Co. *v.* Board of Equalization, 74 Iowa, 181, it was held that among the debts of the plaintiff to its stockholders was the amount which they would be entitled to recover upon a present distribution of the assets of the company. These assets clearly must include the stock, and, hence, if it be treated as a debt owing by the corporation to its stockholders, or which would be due to them if the business of the company was to be wound up, and its assets distributed to those entitled thereto, it would seem to us to follow that, as to the stockholders, the stock which they hold must at least, so far as the matter of taxation is concerned, be treated and considered as 'credits.' * * * If, as is clearly held in this case, the obligation of the corporation to repay the stockholder the amount paid for the stock is a 'debt' of the corporation to the stockholder, it is certain that as to him for taxation purposes, at least, it must be treated as a 'credit.' See, also, Hawkeye Ins. Co. *v.* Board of Equalization, 75 Iowa, 770, where the doctrine announced above is followed and approved."

[1] Van Slyke *v.* State of Wisconsin, 154 U. S. 581; s. c., 14 Sup. Ct. Rep. 1168; Bagnall *v.* State of Wisconsin, ibid. See Adair *v.* Robinson, 6 Tex. Civ. App. 275; Niles *v.* Shaw, 50 Ohio St. 370.

associations within the limits of a state are subject to taxation by the state.[1] But a state cannot tax national bank stock in excess of other moneyed capital of its citizens, as by refusing to deduct the excess of its debts over credits of the stockholders from the amount of their stock.[2] Under the statutes of New York, with reference to taxation of shares of stock of banks, it has been held that an assessment of bank stock in the name of the person appearing on the list furnished the tax officers by the officers of the bank was valid as against the real owner, to whom the shares were transferred before the assessment was made, the assessment in the name of the person appearing on the list as owner being, in effect, an assessment on the shares, against whoever owned them at the time of the assessment.[3] A shareholder in a banking corporation, it has been held in Missouri, is not liable for taxes assessed against the property of the bank under the statutes of that state.[4] The statute of Iowa provides for the taxation of shares of bank stock, and requires the officers to furnish the assessors "the name of each person owning shares, and the amount owned by each." Under that statute an assessment on the capital stock as the personal property of the bank, without mention of the shareholders, has been held to be void.[5] The statute of North Carolina requires the officers of a corporation to list for taxation all the "shares of stock" held therein and the value thereof. It has been held that under this statute the capital stock must be

[2] First National Bank *v.* Chapman, 9 Ohio Cir. Ct. Rep. 79.

[3] People *v.* Barker, 87 Hun, 194; s. c., 33 N. Y. Supp. 1042. For an illustration of an assessment upon the stock of a national bank which was held to be illegal, see People ex rel. Sheldon *v.* Fraser, 74 Hun, 282; s. c., 26 N. Y. Supp. 814; 56 N. Y. St. Repr. 888.

[4] State *v.* Catron, 118 Mo. 280; s. c., 24 S. W. Rep. 439.

[5] Farmers & Traders' Nat. Bank *v.* Hoffmann, (Iowa) 61 N. W. Rep. 418.

listed by the officers of the corporation and not by individual stockholders.[1]

§ 585. Taxation of railroad corporations — rules. — A provision in the charter of a railroad corporation that it should pay to the state a fixed sum as taxes, "and no more," has been held not to relieve it from county taxation.[2] For the purpose of county taxation the roadbed of a railroad company constitutes "real property."[3] The term "capital stock" in the tax law of Kentucky has been held to include the entire property, real and personal, tangible and intangible, as well as the value of the franchise.[4] Where rolling stock is constantly changing the amount for taxation may be fixed by the average amount of the rolling stock used upon a road.[5] The part of a tax paid by a railroad company which has been illegally collected of it, should be applied to valid taxes subsequently accruing against it.[6] A tax upon a railroad corporation which has purchased a railroad, aided by a subscription of a county, for the purpose of meeting that subscription, is limited to the improvements made upon the road after its purchase.[7] A hotel owned by a railroad corporation, leased by it for a summer resort, has been held not to come within the ordinary exemption of the railroad corporation from taxation in Minnesota.[8] The United States Supreme Court has held that the act

[1] Charlotte Building & Loan Association *v.* Board Comrs. Mecklenburg County, 115 N. C. 410; s. c., 20 S. E. Rep. 526. As to taxation of shares of stock in banks, and statements required of the banks in connection therewith, see First Nat. Bank *v.* Bailey, (Mont.) 39 Pac. Rep. 83; Eaton *v.* Union County Nat. Bank, 40 N. E. Rep. 668.

[2] Kentucky Central R. R. Co. *v.* County of Pendleton, (Ky.) 2 S. W. Rep. 176.

[3] Neary *v.* Philadelphia, Wilmington & Baltimore R. R. Co., (Del.) 9 Atl. Rep. 405.

[4] Henderson Bridge Company *v.* Commonwealth, (Ky.) 31 S. W. Rep. 486. What is not double taxation on property of a corporation, see Pacific Coast Ry. Co. *v.* Ramage, (Cal.) 37 Pac. Rep. 532; United States Electric Power & Light Co. *v.* State, 79 Md. 63; State *v.* Bank of Commerce, (Tenn.) 31 S. W. Rep. 993.

[5] Atlantic & Pac. R. R. Co. *v.* Le Sueur, (Ariz.) 19 Pac. Rep. 157.

[6] Northern Pacific R. R. Co. *v.* Raymond, (Dak.) 40 N. W. Rep. 538; State *v.* Missouri Pac. Ry. Co., (Mo.) 6 S. W. Rep. 862. See, also, Boston, C. & M. R. R. Co. *v.* State, 64 N. H. 490; s. c., 13 Atl. Rep. 874.

[7] Louisville & Nashville R. R. Co. *v.* Hopkins County, 87 Ky. 605; s. c., 9 S. W. Rep. 497.

[8] County of Hennepin *v.* St. Paul, M. & M. Ry. Co., 42 Minn. 238; s. c., 44 N. W. Rep. 63. Cases in which the statutes for taxing railroads have been held to be unconstitutional: Central Railroad *v.* State Board of Assessors, 49 N. J. L. 1; s. c., 7 Atl. Rep. 306. Where they were held to be constitutional: Owensboro & N. Ry. Co. *v.* County of Daviess, (Ky.) 3 S. W. Rep. 164. Taxation on "undivided profits" for a railroad company under federal statute construed: Marquette, H. & O. R. R. Co. *v.* United States, 123 U. S. 722; s. c., 8 Sup. Ct. Rep. 319. Taxation upon earnings of a railroad corporation; rules as to computation of, etc.: State *v.* Northern Pacific R. R. Co., 36 Minn. 207; s. c., 30 N. W. Rep. 663. What is taxable property of a railroad corporation: City of Muscatine *v.* Chicago, R. I. & P. Ry. Co., 79 Iowa, 645; s. c., 44 N. W. Rep. 909; Nashua & Lowell Railroad *v.* City of Nashua, 62 N. H. 602; Boston, C. & M. Railroad *v.* State, 62 N. H. 648. Assessment of railroad property for taxation; rules for ascertaining value: People *v.* Hicks, 105 N. Y. 198; s. c., 11 N. E. Rep. 653; Central Railroad *v.* State Board of Assessors, 49 N. J. L. 1; s. c., 7 Atl. Rep. 306; Ohio & Mississippi Ry. Co. *v.* People, 120 Ill. 200; s. c., 10 N. E. Rep. 545; People *v.* Comrs. of Taxes, 104 N. Y. 240; s. c., 10 N. E. Rep. 437; People *v.* Assessor, 2 N. Y. Supp. 240; State *v.* Union Trust Co., (Mo.) 6 S. W. Rep. 867; Morgan's La. & Tex. R. R. & St. Ship Co. *v.* Board of Reviewers, (La.) 3 So. Rep. 507. Rule as to computing the length of a railroad: Herbert *v.* Baltimore & Philadelphia R. R. Co., (Del.) 13 Atl. Rep. 902; State *v.* Nashville, C. & St. L. R. R. Co., 2 Pickle, 438; s. c., (Tenn.) 6 S. W. Rep. 880; State Board of Assessors *v.* Paterson & R. R. R. Co., 50 N. J. L. 446; s. c., 14 Atl. Rep. 610; Todd County *v.* St. Paul, M. & M. Ry. Co., (Minn.) 36 N. W. Rep. 109. Assessment for back taxes; rules governing: State *v.* Hannibal & St. Jo R. R. Co., (Mo.) 11 S. W. Rep. 746; State *v.* Wabash, St. L. & Pac. Ry. Co., 97 Mo. 296; s. c., 10 S. W. Rep. 434. When unauthorized: Franklin County Court *v.* Louisville & Nashville R. R. Co., 84 Ky. 59. Where and by whom assessments of taxation on railroad companies should be made: Oregon Short Line Ry. Co. *v.* Yeates, (Idaho) 17 Pac. Rep. 457; Morgan's La. & Tex. R. R. & St. Ship Co. *v.* Board of Reviewers, (La.) 3 So. Rep. 507; Missouri Valley & B. Ry. & B. Co. *v.* Harrison County, 74 Iowa, 283; s. c., 37 N. W. Rep. 372. Assessment of tax, upon railroad property, in New Hampshire, see Boston C. & M. Railroad *v.* State, 62 N. H. 648. Assessment upon railroad track in Illinois; not to be assessed by local assessor, see Chicago & A. R. R. Co.

of the legislature of Indiana of March 6, 1891, concerning taxation, under the provisions of which there was an assessment upon the railroad company's property by the state board of assessors, not to be obnoxious to the constitutional objections made to it on the hearing, as the Supreme Court of Indiana had decided that the Constitution of that state authorized such a method of assessing railroad property, which decision was binding upon the United States Supreme Court. Further, the act gives the railroad companies the right to be heard before final determination of the question, which construction was also conclusive upon this court. Further than this, a tax law which grants to the taxpayer a right to be heard on the assessment of his property before final judgment,

provides a due process of law for determining the valuation, although it makes no provision for a rehearing.[1] An assessment made upon a railroad company's property in Indiana was objected to on the ground that it was based partly upon property outside of the state, the road running also through the adjoining state. The United States Supreme Court, after a consideration of the questions made, determined as follows: If an assessing board, seeking to assess for purposes of taxation a part of a railroad within a state, the other part of which is in an adjoining state,

v. People, 129 Ill. 571; s. c., 22 N. E. Rep. 864. When corporation is estopped to complain of assessment by town assessor, see Indianapolis & St. Louis Ry. Co. *v.* People, 130 Ill. 62; s. c., 22 N. E. Rep. 854. In Nebraska, see Red Willow County *v.* Chicago, B. & Q. Railroad Company, 26 Neb. 660; s. c., 42 N. W. Rep. 879. In New Jersey, see Williams *v.* State Board of Assessors, 51 N. J. Law, 512; s. c., 18 Atl. Rep. 750. In Iowa, see Missouri Valley & B. Ry. & B. Co. *v.* Harrison County, 74 Iowa, 283. In Kentucky, see Louisville & N. R. R. Co. *v.* Commonwealth, 85 Ky. 198. In Tennessee, see Shelby County *v.* Mississippi & T. R. Co., 16 Lea, 401; s. c., 1 S. W. Rep. 32. In Missouri, see State *v.* Hannibal & St. Jo R. R. Co., (Mo.) 13 S. W. Rep. 505. In New York, see People *v.* Cheetham, 45 Hun, 6; s. c., 20 Abb. N. C. 44; Atlantic & P. Ry. Co. *v.* Yavapai County, (Ariz.) 21 Pac. Rep. 768. The right to attack a valuation of its property, see St. Louis Bridge & Tunnel R. R. Co. *v.* People, 127 Ill. 627; s. c., 21 N. E. Rep. 348, following Railway Co. *v.* People, 10 N. E. Rep. 397. Rule of valuation in Kentucky, see Owensboro & N. Ry. Co. *v.* Logan County, (Ky.) 11 S. W. Rep. 76. As established by earning capacity, see People *v.* Haren, 3 N. Y. Supp. 86. When a railroad bridge must be assessed with the railroad, see State *v.* Hannibal & St. Jo. R. R. Co., 97 Mo. 348; s. c., 10 S. W. Rep. 436. When an assessment is void, see St. Louis & S. F. Ry. Co. *v.* Apperson, 97 Mo. 300; s. c., 10 S. W. Rep. 478; State of California *v.* Central Pacific R. R. Co., 127 U. S. 1; s. c., 8 Sup. Ct. Rep. 1073. Return of miles of railroad in Nebraska for taxation: Cass County *v.* Chicago, B. & Q. R. R. Co., 25 Neb. 348; s. c., 41 N. W. Rep. 246; Chicago, B. & Q. R. R. Co. *v.* School District No. 1, 25 Neb. 359; s. c., 41 N. W. Rep. 249. Taxation of lands granted to railroads; rules: State *v.* Central Pacific R. R. Co., (Nev.) 22 Pac. Rep. 237; St. Paul & Sioux City R. R. Co. *v.* Robinson, 40 Minn. 367; s. c., 43 N. W. Rep. 75; St. Paul & Sioux City R. R. Co. *v.* Shanks, 40 Minn. 369; s. c., 42 N. W. Rep. 83; Sioux City & St. Paul R. R. Co. *v.* Robinson, 41 Minn. 452; s. c., 43 N. W. Rep. 326; Sioux City & St. Paul R. R. Co. *v.* King, 41 Minn. 461; s. c., 43 N. W. Rep. 329. Taxation of railroads for school purposes in Missouri: Chicago & A. R. R. Co. *v.* Lamkin, 97 Mo. 496; s. c., 10 S. W. Rep. 200. Taxation of foreign railroad corporations running into Pennsylvania: Commonwealth *v.* Lehigh Valley R. R. Co., (Pa.) 17 Atl. Rep. 179; Delaware & Hudson Canal Co. *v.* Commonwealth, (Pa.) 17 Atl. Rep. 175.

[1] Pittsburgh, Cincinnati, Chicago & St. Louis Ry. Co. *v.* Backus, (1894) 154 U. S. 421.

ascertains the value of the whole line as a single property, and then determines the value of that within the state upon the mileage basis, that is not a valuation of property outside of the state; and the assessing board, in order to keep within the limits of state jurisdiction, need not treat the part of the road within the state as an independent line, disconnected from the part without, and place upon that property only the value which can be given to it if operated separately from the balance of the road. Where an assessing board is charged with the duty of valuing a certain number of miles of railroad within a state forming part of a line of road running into another state, and assesses those miles of road at their actual cost value, determined on a mileage basis, this does not place a burden upon interstate commerce beyond the power of the state, simply because the value of that railroad, as a whole, is created partly — and perhaps largely — by the interstate commerce which it is doing.[1] The United States Supreme Court declared the rule as to ascertaining the value of railroad property for taxation purposes to be as follows: When a railroad runs into or through two or more states, its value, for taxation purposes, in each is fairly estimated by taking that part of the value of the entire road which is measured by the proportion of the length of the particular part in that state to that of the whole road. Further, they held that the judgment of a state board of assessors, empowered to fix a valuation for taxation, could not be set aside by the testimony of witnesses that the valuation was other than that fixed by the board, where there was no evidence of fraud or of gross error in the system on which the valuations were made.[2]

[1] Cleveland, Cincinnati, Chicago & St. Louis Ry. Co. *v.* Backus, (1894) 154 U. S. 439. The court said: "It has been again and again said by this court that while no state could impose any tax or burden upon the privilege of doing the business of interstate commerce, yet it had the unquestioned right to place a property tax on the instrumentalities engaged in such commerce. See, among many other cases, Marye *v.* Baltimore & Ohio Railroad, 127 U. S. 117; Pullman's Palace Car Co. *v.* Pennsylvania, 141 U. S. 18."

[2] Pittsburgh, Cincinnati, Chicago & St. Louis Ry. Co. *v.* Backus, (1894) 154 U. S. 421. Mr. Justice BREWER, speaking for the majority of the court, said: "The stock and the indebtedness represent the property. As said by Mr. Justice MILLER in State Railroad Tax Cases, 92 U. S. 575, 605: 'When you have ascertained the current cash value of the whole funded debt, and current cash value of the entire number of shares, you have, by the action of those who above all others can best estimate it, ascertained the true value of the road, all its property, its capital stock and its franchises, for these are all represented by the value of its bonded debt and of the

A railroad company securing a state franchise to operate its road, afterwards obtaining a federal franchise, will not by the receipt of the latter be saved from the right of the state to tax the state franchise, the roadbed and other property of the company.[1] Taxes on the right of way of a railroad company cannot be avoided by the company by reason of errors in describing it in the assessment book.[2] The United States Supreme Court has held that the sum received by one railroad company from another for the use of its tracks was a toll within the meaning of a Pennsylvania statute, taxing gross receipts of railroad companies "for tolls and transportations."[3] Land belonging to a railroad

shares of its capital stock.' In Franklin County *v.* Nashville, Chattanooga, etc., Railway, 12 Lea, 521, 539, the Supreme Court of Tennessee, in a well-considered opinion, which was quoted with approval by this court in Columbus Southern Railway *v.* Wright, 151 U. S. 470, 479, thus referred to the means of ascertaining the value of a railroad track: 'The value of the roadway at any given time is not the original cost, nor, *a fortiori*, its ultimate cost after years of expenditure in repairs and improvements. On the other hand, its value cannot be determined by ascertaining the value of the land included in the roadway assessed at the market price of adjacent lands, and adding the value of the crossties, rails and spikes. The value of land depends largely upon the uses to which it can be put and the character of the improvements upon it. The assessable value for taxation of a railroad track can only be determined by looking at the elements on which the financial condition of the company depends, its traffic, as evidenced by the rolling stock and gross earnings in connection with its capital stock. No local estimate of the fraction in one county of a railroad track running through several counties can be based upon sufficient data to make it at all reliable, unless, indeed, the local assessors are furnished with the means of estimating the whole road. * * * This court has expressly held in two cases, where the road of a corporation ran through different states, that a tax upon the income or franchise of the road was properly apportioned by taking the whole income or value of the franchise, and the length of the road within each state, as the basis of taxation. The Delaware Railroad Tax Case, 18 Wall. 206; Erie Railway *v.* Pennsylvania, 21 Wall. 492.'"

[1] People *v.* Central Pacific R. R. Co., 105 Cal. 576; s. c., 38 Pac. Rep. 905.

[2] Cairo, V. & C. Ry. Co. *v.* Mathews, 152 Ill. 153; s. c., 38 N. E. Rep. 623. When the mode of computing a railroad company's tax will not vitiate the tax, see Cairo, V. & C. Ry. Co. *v.* Mathews, 152 Ill. 153; s. c., 38 N. E. Rep. 623.

[3] New York, Lake Erie & West. R. R. Co. *v.* Commonwealth of Pennsylvania, 158 U. S. 431; s. c., 15 Sup. Ct. Rep. 896. See State *v.* Stone, 119 Mo. 668; Herbert *v.* Railroad Company, 8 Del. 120. For rule as to power of the court in an action by a city to recover taxes of a railroad company upon a part of its road, brought within the city by an extension of its boundaries, in ascertaining the amount of taxes due, see Louisville & Nashville R. R. Co. *v.* Commonwealth, (Ky.) 30 S. W. Rep. 624. As to the effect of the

on which was situated its passenger and freight depots, round house, side tracks and terminal facilities has been held in Illinois to be properly assessable as "railroad track" under the statutes of that state, declaring that "such right of way, including the superstructures of main, side or second tracks and turnouts, and the stations and improvements of the railroad company on such right of way, shall be held to be real estate for the purpose of taxation and denominated 'railroad track' and shall be so listed and valued."[1] Trustees of bondholders in charge of a railroad whose main track was all outside the state of Illinois, but the trains of which were brought into the state over the tracks of another company, have been held to be "operating a railroad in this state" within the meaning of the statute of that state requiring those "owning, operating or constructing a railroad in this state" to return schedules of its taxable property.[2] The tax assessed upon a railroad company's property is a lien on all the property assessed, the property being assessed as a unit and the tax being due as a unit.[3]

Washington statute imposing a tax on "gross earnings" of railroad corporations in lieu of all other taxes, in exempting the property of the corporation from taxation, see Columbia & P. S. R. R. Co. *v.* Chilberg, 6 Wash. 612; s. c., 34 Pac. Rep. 163. As to what erections upon its land and improvements by a railroad corporation are so necessarily connected with its general business as to come within a statutory exemption of its property from general taxation, see Chicago, St. Paul, M. & O. Ry. Co. *v.* Bayfield County, (Wis.) 58 N. W. Rep. 245. As to railroads taxable under the Constitution of Florida of 1868, see Bloxham *v.* Florida Central & P. R. R. Co., (Fla.) 17 So. Rep. 902.

[1] Quincy, O. & K. C. Ry. Co. *v.* People, (Ill.) 41 N. E. Rep. 162.

[2] Ibid. That a railroad corporation operating a railroad from a point in the state to a point in another state, being liable to the tax prescribed on gross earnings under the New York statutes, as a tax on franchise, see People ex rel. Dunkirk, Alleghany Valley, etc., R. R. Co. *v.* Campbell, 74 Hun, 210; s. c., 26 N. Y. Supp. 832; 56 N. Y. St. Repr. 358; citing People ex rel. Pennsylvania R. R. Co. *v.* Wemple, 138 N. Y. 1; People *v.* Home Ins. Co., 92 N. Y. 328; People ex rel. Southern Cotton Oil Co. *v.* Wemple, 131 N. Y. 64. In Maricopa & Phœnix R. R. Co. *v.* Arizona Territory, 156 U. S. 347, where the United States government, through congress, had granted to the railroad corporation, organized under the laws of the territory, a right of way over an Indian reservation within the territory, the road being constructed entirely within the territory, it was held that the part of the road within the reservation was subject to taxation by the territorial government.

[3] Maricopa & P. R. R. Co. *v.* Territory of Arizona, 156 U. S. 347; s. c., 15 Sup. Ct. Rep. 391. As to exemption of a railroad company from taxation for five years under Kentucky statute, see Commonwealth *v.* Louis-

§ 586. Taxation of insurance corporations.— The Kansas Supreme Court has held the reserve fund of a mutual life association, organized on the co-operative plan, it having no capital stock, subject to taxation in that state.[1] They also held that the contingent liabilities of the association to the holders of its policies, were not such indebtedness of the corporation as could be deducted from the credits of the association subject to taxation.[2]

ville, St. Louis & K. Ry. Co., (Ky.) 31 S. W. Rep. 464. For illustrations of exemptions of railroad corporations from taxation which would not relieve them from assessments for local improvements, or special taxes for street pavements adjacent to their right of way, see Lake Shore & Michigan Southern Ry. Co. *v.* City of Grand Rapids, (Mich.) 60 N. W. Rep. 767; Illinois Central R. R. Co. *v.* City of Decatur, 154 Ill. 173; s. c., 39 N. E. Rep. 626. See, also, Commonwealth *v.* Railroad Company, 95 Ky. 60; Chicago, St. P., M. & O. Ry. Co. *v.* Bayfield County, 87 Wis. 188; State *v.* District Court, 54 Minn. 34; Fargo & S. W. R. R. Co. *v.* Brewer, 3 N. Dak. 34; Commonwealth *v.* Railway Company, 93 Ky. 430.

[1] Kansas Mutual Life Association *v.* Hill, Treasurer of Brown County, 51 Kans. 636.

[2] Ibid. The court's attention was called upon this point to Insurance Company *v.* Lott, 54 Ala. 499, and Equitable Life Ins. Co. *v.* Board of Equalization, 74 Iowa, 178; s. c., 37 N. W. Rep. 141, upon which the association's counsel relied, was distinguished by the court in these words: "The statute of Iowa allows a taxpayer to deduct his indebtedness from the amount of money or credits which he is required to list, and in that respect is quite unlike our own, which only allows such deduction to be made from credits not secured by liens on real estate, nor due from a bank on demand. The plaintiff in that case was a stock company to which its stockholders had contributed on their shares $100.000. The court regarded the shares as taxable at their cash value in the hands of the stockholders, and that this cash value would be augmented by whatever accumulations of profit the company held, to which they would be entitled in case of distribution. In the plaintiff company there are no stockholders. The policies issued by the plaintiff in that case were not forfeited by failure to pay premiums after two payments, but a paid-up policy was issued for an amount fixed by the terms of the policy. The court held the reserves on such policies debts owing by the company. In this case no such policies are outstanding. On the other hand, there are many authorities which hold that the contingent liabilities of insurance companies, both life and other, on policies outstanding before loss occurs, are not debts within the meaning of the statute, which may be deducted from the credits of the company. 1 Desty Tax. § 79; Insurance Co. *v.* Cappellar, 38 Ohio St. 560; Kenton Ins. Co. *v.* City of Covington, 86 Ky. 213; s. c., 5 S. W. Rep. 461; People *v.* Davenport, 91 N. Y. 574; People ex rel. *v.* Commissioners, 76 N. Y. 64; Fire Ins. Co. *v.* Parker, 35 N. J. Law, 575; Sun Mut. Ins. Co. *v.* Mayor, etc., of New York, 8 N. Y. 241. The general rule is that all property must bear its share of taxation, unless expressly exempted therefrom. * * * A contingent liability which is not susceptible of computation is not a debt owing in good faith which may be deducted from credits under the tax law. * * *"

An insurance corporation, vested by its charter "with all the powers, privileges and immunities" of an older existing corporation, the Supreme Court of Tennessee held to be vested with a valid exemption from taxation contained in the charter of the older one.[1] But should the charter clothe the corporation "with all the rights and privileges" of such older existing corporation, without more, those words would not carry the exemption of the older corporation to the later one.[2] The Supreme Court of Tennessee has held that under a clause of the charter of an insurance company, that "there shall be a state tax of one-half of one per cent upon the amount of capital paid in," the capital stock, and not the shares, was taxed; and that under the charter provision the capital stock was exempted by implication from all taxation, whether state, county or municipal, other than the charter tax. This exemption, however, they held did not extend to the shares of stock.[3] Where corporate officers were in default in furnishing to the assessor of taxes the names of shareholders, the assessor assessed the shares of stock to "unknown owners." The Supreme Court of Tennessee held that the tax so assessed could be collected either by direct suit against the corporation, especially if it was a dividend-paying corporation, or by suit against the corporation and its officers, seeking discovery of the names of its shareholders, in order that they might be made parties by the supplemental bill.[4]

554; Brennan *v.* Mississippi Home Insurance Co., 70 Miss. 531.

[1] Memphis *v.* Phœnix, etc., Insurance Co., 91 Tenn. 566.

[2] Ibid. The court referred to Railroad Co. *v.* Hicks, 9 Bax. 442; State *v.* N. C. & St. L. Ry., 12 Lea, 583; Railroad Company *v.* Hamblen County, 102 U. S. 273; Wilson *v.* Gaines, 103 U. S. 417. As to exemptions of insurance corporations from taxation under statutes, see People, etc., *v.* Reliance Marine Insurance Co. (Lim.), 70 Hun,

[3] Memphis *v.* Home Insurance Company, 91 Tenn. 558; citing Memphis *v.* Union & Planters' Bank, 91 Tenn. 546; Union Bank *v.* State, 9 Yer. 490; St. R. Co. *v.* Morrow, 87 Tenn. 406; Memphis *v.* Ensley, 6 Bax. 553; Gas Light Co. *v.* Nashville, 8 Lea, 406; Farrington *v.* Tennessee, 95 U. S. 679; Tennessee *v.* Whitworth, 117 U. S. 136.

[4] Memphis *v.* Home Insurance Co., 91 Tenn. 558.

[End of Volume II.]

GENERAL INDEX.

GENERAL INDEX.

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